THE SECTION 203(K) HOUSING PROGRAM

FIELD HEARING

BEFORE THE

SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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MONDAY, SEPTEMBER 10, 2001

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS,
COMMITTEE ON FINANCIAL SERVICES,
New York, NY

The subcommittee met, pursuant to call, at 10:00 a.m., at the Adam Clayton Powell Office Building, 163 West 125th Street, New York, NY, Hon. Sue W. Kelly, [chairwoman of the subcommittee], presiding.

Present: Chairwoman Kelly; Representatives Grucci, Rangel, and Israel.

Chairwoman KELLY. Good morning. This hearing of the House Financial Services Subcommittee on Oversight and Investigations will come to order. I want to thank all the Members of Congress who are present today. Without objection, all Members will participate fully in the hearing, their statements and questions will be made part of the official hearing record. Specifically, I want to thank my friend and House colleague Charlie Rangel for his assistance in planning this hearing and for securing this room for our use.

I also want to take a moment to express my gratitude to Secretary Martinez for making the resolution of the problems in the Section 203(k) program one of his highest priorities.

I would like to inform Members and witnesses that it is my intention to limit statements and questions to 5 minutes each. We have plenty of time to hear all viewpoints, but we need to maintain the decorum that is required of all Congressional hearings. So please, please, do not applaud or comment loudly for a particular witness.

The Section 203(k) program was intended to strengthen communities and improve available housing. Unfortunately, fraud perpetrated under this program has had a devastating impact on families and neighborhoods in New York.

The focus of this hearing will be to find out why this was allowed to happen and how to prevent it from ever happening again. The question that remains unanswered, and which I hope we can answer during this hearing is, where were senior HUD officials when all this fraud was taking place? According to reports issued as early as July, 1996, the HUD Inspector General and the General Accounting Office found that fraud in the Section 203(k) program was harming individual homeowners, renters and communities and placing taxpayer dollars at risk.

In July of 1996, and again in February of 1997, the HUD Inspector General's office said, and I quote: "The Section 203(k) program is highly vulnerable to waste, fraud and abuse by investors and non-profit borrowers." Four months later, in June of 1997, then-Secretary Cuomo instituted his 20-20 Management Reform Plan, a plan which raised red flags with Federal investigators concerned with HUD's oversight ability.

Four months after that, in September, 1997, the HUD Inspector General issued its Semi-annual Report to Congress expressing concern over the fast pace with which then-Secretary Cuomo's reforms were being implemented. Secretary Cuomo's plans, Federal investigators said, put in jeopardy HUD's ability to effectively oversee its own programs, and indeed, starting in late 1997 and into 1998, HUD's single family program was at its most vulnerable point, according to Federal investigators.

In 1999, after this scam had become full blown, the GAO said HUD officials still had done little to address the problems identified by its Inspector General and others. The warnings were there. Time after time, Federal investigators warned of abuse. Here they are, all of these reports warned of problems in the Section 203(k) program and yet they were ignored. Where was HUD?

Then-Secretary Cuomo knew this problem existed, yet allowed it to balloon into a $130 million defrauding of the American taxpayer. Because of this scam, dozens of coconspirators, crooked investors, phony non-profits, willing appraisers and greedy attorneys have already been arrested and there is more to come.

These felons falsely inflated the prices of these properties, lied to obtain HUD insured loans they needed to buy and rehabilitate the properties, pocketed the money, defaulted on the loans and every single one of us who pays taxes is now stuck with this bill. Again, where were senior HUD officials when taxpayer dollars were being stolen?

A large part of Secretary Cuomo's plan involved shifting resources, a full 10 percent of the staff resources went to his Community Builders Program, a program which served no oversight function whatsoever, but rather a public relations function. In fact, the HUD Inspector General testifying before a Senate panel last year, said that the majority of Community Builders said they spent more than half their time on public relations activities.

The Inspector General continues: "HUD redirected a significant amount of resources to outreach and customer relations activities at a time when additional resources were needed for operational activities."

Now, hundreds of New York families are at risk, risk of losing their homes. Other families have been deprived of an opportunity to purchase a home and renters have had to live in buildings that are falling apart. Where was HUD while residents of this community were being preyed upon and denied quality housing? Hundreds of millions of dollars in federally-insured loans have been lost while criminals lined their pockets with taxpayer money.

How could this frenzy of corruption have been missed by Secretary Cuomo and senior HUD official management in light of repeated warnings by Federal investigators? Last year, the HUD Inspector General's Office testified before the Senate that, quote: "the large number of staff devoted to public relations took away staff resources from important oversight functions.”

Sadly, this program is a casualty of Secretary Cuomo’s obsession with spin and public relations, rather than sound public policy.

In closing, let me cite one last Inspector General’s report that addresses this issue. A 1999 HUD Inspector General’s report stated that Secretary Cuomo’s reform efforts had, and I quote: “a criminalizing effect on many of HUD’s ongoing operations.”

Clearly, the Section 203(k) program was one of the programs hardest hit by a disturbing pattern of mismanagement and neglect over the past several years at HUD.

I look forward to the testimony from these witnesses today, and I turn now to my colleague, Congressman Charlie Rangel for his opening statement. Congressman Rangel.

[The prepared statement of Hon. Sue W. Kelly can be found on page 42 in the appendix.]

Mr. RANGEL. Thank you so much, Madam Chairwoman. On August the 28th, I received an invitation from you inviting me to participate in this hearing and to request my support in making certain that it took place and, of course, even before that I indicated my willingness to do this.

It is my understanding at that time, and it remains my intent, not only to see what went wrong, but to see what went wrong for the purpose of seeing that it does not reoccur, and also to make certain that my community and those communities that have been adversely affected as a result of the fraudulent and criminal behavior of certain people, most of whom I hope are arrested by now, that they are made harmless.

That’s why I’m a little surprised that for over a dozen times you mentioned the name of the former Secretary of HUD, whom I’m certain you’re aware of, is a candidate for the Governorship of the State of New York.

Nowhere in your letter do you mention, Mrs. Secretary, and I see a lot of emphasis that’s been made on the C, and I assume that means political appointees of the Secretary of HUD. I want to assure you that my community sincerely wants to help you, the witnesses, but more importantly, that those people would like to see a revitalization of our community with the support of HUD, and I don’t intend to get involved in allowing my political observation of this Administration to interfere with this hearing as relates to making my community whole, and I’m prepared to accept the fact that your concerns about the previous Administration was the only reason why you saw fit to mention the name of the former Secretary a dozen times and I thank you for not mentioning the President, who was Bill Clinton, who is not a candidate for public office.

Whatever the purpose, I’m prepared to admit that Andrew Cuomo’s name was mentioned so often this morning only for the purposes of identification and for those of you who may not have known that the Secretary was Secretary Andrew Cuomo, a candidate for Governor of the State of New York.

Having said that, I do want to thank the witnesses who have been heard, who have come here, the public servants who have no political axe to grind, that we rely on, no matter who is elected, to make certain we will correct the wrongs and move forward, and who I'm confident that at the end of the day you'll have some wonderful suggestions.

As Tip O'Neill—you'll pardon the expression, once said, "all politics is local." I'd like to pay tribute to my City Councilman Bill Perkins, who was merely responding to an eviction notice by one of his constituents, but, because he just didn't accept the fact that their furniture and worldly belongings were placed on the street, because he didn't accept the fact that the landlord was an unknown corporation, because he didn't accept the fact that he found out that similar people were situated that were not in his Councilmanic District, and because he did take it to the New York County District Attorney's office for further investigation, I just want to publicly thank him for bringing this to our Government's attention.

I think to a large extent that's the reason why we held this hearing.

[Applause.]

Chairwoman KELLY. I cautioned this audience before. This is a regular Congressional hearing and we will have to have no comment and no sound, please, from the audience during this hearing. We have witnesses here and we are on a time-line. We need to hear our witnesses. I'm sorry, Congressman Rangel, that you were interrupted.

Mr. RANGEL. Well, thank you, and I'm anxious to hear from the witnesses and I'd like to hear what positives come out of the hearing this morning.

Chairwoman KELLY. Thank you. I think Congressman Rangel touched on an important point. This hearing is about people in the State of New York having a decent place to live and the loss of taxpayer money, and whenever anyone charges this is politics, they're trying to avoid the facts. The fact is that they are doing a great disservice to the people in New York who have been hurt by the ignoring of this program.

Incidentally, this did happen on President Clinton's watch, but he was not at HUD. Secretary Cuomo was at HUD.

Mr. RANGEL. Let me take this opportunity to thank our current President George Bush for straightening out the problem and bringing it to a positive conclusion.

Chairwoman KELLY. We're going to get it concluded today.

Turning right now to a Congressman who has joined us, Congressman Felix Grucci. Congressman Grucci, do you have an opening statement?

Mr. GRUCCI. Yes, I do. Thank you for hosting this hearing, Congressman Rangel. It is great to be in your District and great to be amongst you all today. Some of you may be wondering why a Congressman from the First Congressional District, which is Eastern Long Island, is attending this meeting. The answer is easily identified in the fact that the fraud in this system isn't unique in this particular area, it seems to have been running rampant and seems to have been out of control.

In my area there is a faith-based organization that has been victimized by unscrupulous commercial bankers, a home mortgage banking corporation to take on 132 homes, a small faith-based organization, spreading everywhere from my District out on the east end of Long Island into Queens and possibly as far north and west as where we are sitting here today. The system is broken and it needs to be overhauled and it needs to be fixed, because the purpose here is to insure that the quality of life continues to improve for the American citizen, and so that everyone has the opportunity to achieve the dream of homeownership and decent living conditions and a place they can raise their family in comfort and knowing that the house they live in isn't about to fall apart or they're about to be evicted or the program that they're in is not really doing the job it's supposed to do. This Oversight Subcommittee and this hearing today hopefully will get at the root of this problem, will fix it and will continue to be able to provide the American dream to so many people, where that American dream may be outside of their reach without programs like this.

So I thank you, Chairwoman, for putting this hearing together; Congressman Rangel, thank you for hosting this in your District today, and I look forward to the testimony from the witnesses, and I think it might get a little hot before the day is over with.

Chairwoman KELLY. Thank you very much, Mr. Grucci.

If there are no more opening statements, we are going to begin with our first panel. The first panel will focus on the action, or lack of action, by past HUD management during the 1997-2000 time period with respect to the Section 203(k) scandal. For our first panel, we're grateful that the Honorable John C. Weicher, Assistant Secretary and Federal Housing Commissioner could join us today. Assistant Secretary Weicher has the responsibility for running the Section 203(k) program at HUD. He has devoted his career to housing and urban issues and has served at HUD in three previous Administrations.

Next to him, we have Mr. Stanley Czerwinski, the Director for Physical Infrastructure Issues at the General Accounting Office, which is the official and nonpartisan investigative arm of the Congress. Mr. Czerwinski is the GAO expert on housing issues. After that, we will hear from Mr. Robert C. Groves, the Assistant Inspector General for Investigation from the HUD Office of Inspector General, which is the office that audits HUD programs and conducts criminal investigations. As the top cop for the Inspector General, Mr. Groves has led the investigation's fraud program.

You are all aware that this subcommittee is holding an investigative hearing. When doing so, the Chair may decide to take testimony under oath. Do any of you have any objection to testifying under oath?

PANEL. No objection.

Chairwoman KELLY. Then I advise you under the rules of the House and the rules of the Committee, you are entitled to be advised by counsel. Do any of you desire to be advised by counsel during your testimony?

PANEL. No.

Chairwoman KELLY. In that case, please rise and raise your hands, I'll swear you in.

[Witnesses sworn.]

Chairwoman KELLY. Thank you very much. Each of you is now under oath, and without objection, the written statements will be made part of the record. You will each now be recognized for a 5-

minute summary of your testimony and let us begin with Assistant Secretary Weicher.

STATEMENT OF HON. JOHN C. WEICHER, ASSISTANT SECRETARY FOR HOUSING/FEDERAL HOUSING COMMISSIONER, HUD

Mr. WEICHER. Thank you, Chairwoman Kelly and thank you for holding this important hearing. I'm honored to be here today on behalf of Secretary Martinez to describe present efforts to address the problems in HUD's Section 203(k) program here in New York, problems that were caused by fraud and abuse during 1998 and 1999.

With me this morning are Sean Cassidy, General Deputy Assistant Secretary for Housing; Mary Ann Wilson, the Secretary's representative in our New York office; Frederick Douglas, Deputy Assistant Secretary for Single Family Housing; Joseph McCloskey, Director of the Office of Single Family Asset Management and Ingram Lloyd, Director of our Philadelphia Home Ownership Center. All of these HUD staff members have worked long and hard on these problems.

We are here to discuss a major abuse of a HUD program. The Department has engaged in an intense effort to understand how the program abuse occurred, how to deal with it and how to prevent it in the future, here and elsewhere. I will discuss each of those subjects this morning and just summarize my testimony.

In the Section 203(k) program, the FHA insures mortgages that finance both the purchase of the home and repair of the property after purchase. The lender is required to approve drawdowns from a repair escrow and ensure the adequacy of the repairs themselves. Over the last 7 years, FHA has insured about 80,000 of these mortgages.

The Section 203(k) program is a single family home mortgage program, but it is possible to obtain FHA insurance with properties for up to four units and for larger properties being converted to no more than four units. Most of the New York properties are in these last two categories, and that is unusual. Nationally, 80 percent of the Section 203(k) loans are one-family houses.

The Section 203(k) program is inherently more risky than FHA's standard home mortgage insurance because of the repair component. FHA has a 14 percent default rate on Section 203(k) loans, compared to 2 percent on our basic Section 203(b) home mortgage insurance program.

Briefly, here is what happened in New York: During 1998 and 1999, FHA insured mortgages on 720 properties in and around the city that were sold to non-profit organizations. Of these, 545 are located in Brooklyn or Harlem and another 85 are in Queens or the Bronx. Under Section 203(k), the nonprofits made a commitment to rehabilitate the properties and resell them, but in fact, the actual transaction was conducted by companies with ties to loan officers, investors who were barred from the program. Escrowed monies to be used for rehab were then funneled to developers who actually did little or no work. Kickbacks were paid to the various parties involved in the fraud. Lenders failed to perform their legal duties to ensure the repairs were completed and escrow funds were handled in an irresponsible manner. Some were in collusion with investors.

These loans are the subject of ongoing investigation by the Department of Justice, by local authorities and by HUD's own Office of the Inspector General. I understand that 33 individuals have been indicted to date. We are supporting these investigations and we have also proceeded with administrative actions as well. We have taken action against 113 organizations and individuals, and we have levied civil money penalties of over $1 million. I have listed these in my full statement and they take up over a page.

We expect to pay more than $130 million for insurance claims on these properties. That does not include the cost of property rehabilitation. Our initial estimate for the rehab is $80 million. Most important, several hundred households are living in appalling conditions and the buildings are a blight on the neighborhoods.

Last week, I came here with Mr. Cassidy, Ms. Wilson, and Mr. Lloyd. We looked at 42 of these properties, here in Harlem, within a few blocks of this building, and also in Brooklyn in Bedford Stuyvesant and Bushwick. The property of one of the witnesses in the second panel, Ms. Browne, was one of the properties we looked at. We saw vacant lots, burned-out buildings, buildings with missing staircases, and buildings with broken windows. Many were boarded up, and about half were occupied. Nearly all need significant rehab work before they can provide decent housing.

Upon his appointment, Secretary Martinez created a HUD team to address this fraud. On May 11, the Secretary announced a preliminary plan with several components: To protect all current legal residents and offer them affordable leases; to bring the property up to minimum property standards, free of health and safety problems, and supplied with adequate heating, plumbing, electricity, and other basic utilities; to pay the cost of rehabbing the properties; to bear the cost of any temporary relocation made necessary by the rehab work; and to allow for disposition of the properties to both for-profit and non-profit purchasers.

The Secretary also invited the city's Department of Housing Preservation and Development—HPD—to assist in developing a more detailed solution, and in response, HPD has offered to assume a primary role in overseeing the rehab and disposition of the properties. HPD will draw on its extensive experience in rehabbing similar properties in New York, in many cases, properties on the same block. The Department welcomes this proposal. It is now under active consideration by program staff and the Office of General Counsel, and I want to thank Commissioner Jerilyn Perine from HPD for her strong commitment to solving the problems with which we are all now confronted. When we looked at these properties earlier last week, Commissioner Perine joined us, and we had a very useful discussion.

In the interim, the Department is employing two property management firms to maintain these properties and make sure the residents have basic utilities. We are hampered by the fact that HUD currently owns only 156 of the properties. Another 460 are in default, but the sponsors remain the legal owners, even though they are now excluded from doing new business with HUD. The owners are not being very cooperative as we head into the fall and winter, so the Department has instructed the mortgage companies that currently service these loans to reestablish utilities if the utilities are cut off in these buildings, and HUD will reimburse the servicers for this expense, something we normally do.

In addition, the Department is carefully analyzing the Section 203(k) program activity around the country. Our best evidence is that the fraud here is unique. In the period since this scam started, the cumulative claim rate on Section 203(k) claim loans to non-profits is 14 percent in New York City compared to 5 percent for the rest of the country.

The program has now been changed in several important ways to forestall this type of fraud elsewhere. In my statement, I have listed several actions that HUD took last year. This year, Secretary Martinez has instructed us to rigorously review program operations and the program control structure. One proposed regulation is currently finishing the 15-day Congressional review period. We are prepared to develop further regulations as necessary. We will also work with the city, with community groups, with non-profit and for-profit entities and the unfortunate residents of these properties. The Secretary's first concern is to see that the people living in the properties are decently housed and do not suffer from fraud that occurred around them.

Finally, we will continue to hold lenders and other participants accountable for fraud and failure to comply with the requirements of the program. Thank you, Chairwoman Kelly. I will be glad to answer questions.

[The prepared statement of Hon. John C. Weicher can be found on page 45 in the appendix.]

Chairwoman KELLY. Thank you, Mr. Weicher.

We now turn to Mr. Czerwinski.

STATEMENT OF STANLEY J. CZERWINSKI, DIRECTOR, PHYSICAL INFRASTRUCTURE ISSUES, GENERAL ACCOUNTING OFFICE

Mr. CZERWINSKI. Madam Chairwoman, Congressmen, we're happy to testify today on the Section 203(k) program, but my objective today is to provide you with a road map of things we think the agency can do to help improve the program. Before I start I'd like to introduce the two people who did most of the work. Paul Schmidt, who is our Assistant Director for all single family housing, and next to him is Rick Smith, our lead investigator for the Section 203(k) review.

Chairwoman KELLY. We welcome them.

Mr. CZERWINSKI. I'd like to start by saying that Section 203(k) is a worthwhile program. Used correctly—and that's the key word, correctly—Section 203(k) can rehabilitate properties, can revitalize neighborhoods and provide homeownership opportunities where you otherwise would not have them, but as Mr. Weicher noted, Section 203(k) is inherently complicated and risky. This is due to features both unique to Section 203(k), as well as all of FHA. With Section 203(k), the unique feature is, again, as Mr. Weicher noted, that you're combining the financing for the purchase and the rehabilitation into a single mortgage. However, Section 203(k) is built on also a structure that has basic risk and that is FHA insures 100 percent of all the mortgages.

Today, with that backdrop, what I'd like to do is briefly describe Section 203(k). Walk you through some things that we think are particular points within that area and give suggestions to how to fix it.

Section 203(k) was established in 1978, but it really didn't become significant in size until 1994, and again, as Mr. Weicher noted, what we're talking about is a single mortgage that covers both the purchase and rehabilitation of properties with a 100 percent Federal guarantee. Because of the 100 percent Federal guarantee, it's important to hold accountable all the players involved, and in the case of Section 203(k), because it is more complicated, you have more players to hold accountable. In the case of FHA, the two major players to hold accountable are the lenders who underwrite the loans and the appraisers who turn in the values.

We've done reviews of FHA in general and lenders, appraisers and found significant problems; lenders making loans to unqualified borrowers, appraisers valuing properties far above their level. The fix to this is three-fold. You need to approve only lenders who will do a good job, even if you have a tight approval process. Constant monitoring has to take place, again, because the liability is on the Federal Government, not the lenders or the appraisers. Finally, when you do find inaccuracies, it's important to take action, enforcement action against them.

As I mentioned, Section 203(k) becomes particularly troublesome, because the lender is financing not only the purchase, but the promise to rehab and the appraiser is not just appraising the value of the property as is, but some estimate of what it's going to be like when its fixed.

So our recommendation to HUD is they need to pay close attention in approving, monitoring and enforcing the actions of lenders and appraisers and they need to pay special attention to this in the Section 203(k) program, and this is the litany you will hear from us; approving, monitoring, enforcing.

In addition, there are two other pain points within Section 203(k) and we found these to be very problematic in the past. The first is participation of consultants, the second is the participation of non-profits. Consultants are there because the program is complicated. They're there ostensibly to help the borrower, help the borrower plan, help the borrower oversee the property rehabilitation. They can also approve the drawdown of payments when work is complete. As the picture on your right shows, that's not always the case.

This is a property that our team visited in Chicago. In this property, the borrower received $60,000 to fix up that property. That's a picture of a fixed up property. The consultant approved all drawdowns of the $60,000, and that borrower was left with things like exposed wiring, unframed doorways, unfinished plastering, gaping holes in walls and ceilings. She was faced with that as a single person to pay for on her own, because the consultant said that work was complete. That is the problem.

Another area of problems, and we talked a little bit about this, is the participation of non-profits. Non-profits typically get involved in Section 203(k), fix up properties, revitalize the neighborhood, provide homeownership opportunities and affordable rental housing where there would be none. But the problem is non-profits typically nationwide have caused twice as many claims as the next nearest group of borrowers. This typically arises for a couple of reasons. One, the non-profit may lack experience, they get in over their heads or, two, and this is what you see in Harlem, they've been co-opted by lenders, contractors, consultants, speculators.

To improve the performance of both consultants and non-profits, we have recommended that HUD strengthen the criteria for admittance into the program be recertified periodically, periodically review the performance to make sure they're performing in a way that's acceptable. HUD has begun acting on the recommendations to be put in place. However, it's just beginning, and because of the inherent risk involved in Section 203(k), no matter how much we put in place, it's going to require stringent oversight and vigilance if we're going to see this program work.

That concludes my statement. I'll be happy to answer any questions you have.

[The prepared statement of Stanley J. Czerwinski can be found on page 52 in the appendix.]

Chairwoman KELLY. Thank you very much, Mr. Czerwinski.

Now we turn to you, Mr. Groves.

STATEMENT OF ROBERT C. GROVES, ASSISTANT INSPECTOR GENERAL FOR INVESTIGATION, HUD OFFICE OF INSPECTOR GENERAL

Mr. GROVES. Thank you, Chairwoman Kelly, other subcommittee Members. With me today I have Ruth Mitsma, she's the Special Agent in Charge of Auditing in the New York/New Jersey District, and Stan McCloud is the Audit Director of the Finance Committee.

I appreciate the opportunity to appear today to discuss our investigation of the Section 203(k) frauds in Harlem. I have submitted my written testimony for the record and I'd like to focus on the few key points of that testimony. The Section 203(k) program allows a borrower or a not-for-profit organization to get a mortgage to cover the current price of the property in need of repair, as well as the estimated cost to rehabilitate it. Investors are not permitted to participate in the program. HUD must assure that the total costs are reasonable for the market area.

The program generally requires the rehabilitation portion of the loan to be escrowed by the lender and drawn down as the work is completed over a 6-month rehab period. HUD approved direct endorsement lenders generally to perform this task for FHA during the underwriting process. Obviously, such loans present a greater risk to HUD because of the inherent uncertainties of rehabilitation work.

When the Section 203(k) frauds in Harlem occurred, HUD's oversight was extremely limited, and HUD employees were extremely and severely distracted. HUD was undergoing a major reorganization under former Secretary Cuomo's 20-20 reform plan, where the push quickly downsized HUD. About 1,000 mostly senior level staff took the buyout at the end of 1997. Those leaving with buyouts were primarily housing program employees. Additionally, many positions in the department were being abolished as employees were being forced to apply for new positions in the new HUD. The focus of many employees at this time was survival, finding a job outside of HUD or a position within the reorganized department.

By early 1998, HUD's single family staff had been cut almost in half, and all of the remaining positions were moved to a consolidated homeownership center in Philadelphia.

Against this backdrop, the Section 203(k) program was growing. Our investigations found numerous abuses of the Section 203(k) program. Hundreds of properties were affected by this scandal. Millions of dollars in FHA loans are virtually worthless and neighborhoods remain blighted. Among the abuses we found, ineligible investors used not-for-profit organizations as fronts to buy properties at inflated values. Appraisal companies used unrealistic properties as comparables in determining realistic property values and lender employees helped to falsify the credit worthiness of certain not-for-profit buyers and then helped in altering the rehabilitation work sheets so that FHA loans could be insured.

Please direct your attention to the chart that illustrates just one fraud enterprise involving 270 loans originated by officers and employees of Mortgage Lending of America. This involved collusion of lender employees, multiple investors, real estate attorneys, lenders and 13 separate not-for-profit organizations. Of the 270 originated loans, 267 are in default with a potential loss to HUD of $77.8 million.

My written testimony, for the record, indicates the magnitude of the losses and the nature of the fraud conspiracies, but today I'd like to give an illustration of what happened in the cases of just two Harlem properties.

The first property is 157 East 121st Street. This picture was taken in the fall of 1998. An investor purchased that abandoned building on December 18th for $60,000. Five days later, title to this property was transferred to a not-for-profit for $225,000 on a HUD-secured FHA 203(k) mortgage of $355,700. At that time, the $225,000 in loan proceeds were divided among the conspirators. The remaining $130,700 was escrowed to pay rehabilitation costs. This property went into default in less than one year.

The next picture was taken 2 weeks ago. Since it appears that no rehabilitation work was performed on this property, HUD's insurance loss will be substantial.

The second property I'm going to talk about is 316 West 113th Street. This picture was taken in the summer of 1998. An investor purchased this lot with foundation on July 1, 1998 for $35,000. Six days later, title to this property was transferred to a not-for-profit for $160,000 on a secured FHA 203(k) mortgage of $327,400. At that time, $160,000 in loan proceeds were divided among the conspirators. The remaining $167,400 was escrowed, to pay rehabilitation costs. This property quickly went into default.

The next picture was taken 2 weeks ago. Since it appears that no rehabilitation work was performed at all on this property, HUD's insurance loss will be substantial, and, by the way, Mortgage Lending of America is out of business, and any hopes of recovering any of the escrowed funds either on these properties is doubtful.

There seems to be a feeding frenzy of the various criminal groups that profit from the vulnerabilities of the Section 203(k) program. Often members of the enterprise replicated the frauds with new conspirators. Often members of the enterprise, not only HUD, but poor neighborhoods targeted for improvement were victimized.

There are hundreds of properties in the New York area like the two I've shown you. Our office is working very closely with the United States Attorney's Office, the Manhattan District Attorney's office and others to investigate, indict and convict those parties that were involved in these schemes to defraud HUD. In this investigation I have described to you there have been 33 arrests and 19 of those individuals have entered guilty pleas. Until everything is settled, taxpayers will lose tens of millions of dollars.

In this instance, the American people were committed to investing hundreds of millions in poor neighborhoods to make them decent, good places to live. In Harlem, religious not-for-profit and other not-for-profit organizations working in partnership with criminals aggressively pilfered nearly the entire investment that had been set aside to help vulnerable and disadvantaged elements of our society.

HUD's poor management allowed this slow moving theft of huge proportions to be undetected until it was too late.

That concludes my testimony and I'd be pleased to answer any questions.

[The prepared statement of Robert C. Groves can be found on page 58 in the appendix.]

Chairwoman KELLY. I thank you very much, Mr. Groves. I have a few questions for this panel and then I'll turn to the other Congressmen.

Mr. Groves, is it your assessment that then Secretary Cuomo's rush to implement that 20-20 Management Plan you described, despite repeated warnings, apparently, to slow down, had an impact on the Section 203(k) fraud that was going on?

Mr. GROVES. Absolutely. All the monitoring of that program became negligible.

Chairwoman KELLY. It now appears that during a time when additional resources were needed for HUD to oversee its programs, Secretary Cuomo shifted 10 percent of the staff resources to his community builders program. Was this drain on resources a contributing factor to the lack of oversight of HUD programs?

Mr. GROVES. Yes, ma'am, it was.

Chairwoman KELLY. Do you want to elaborate on that a little bit?

Mr. GROVES. Basically we had almost a thousand people in the single family program whose jobs were eliminated. That 1,000 people represented the oversight in most of the single family program including the Section 203(k) program. In New York, 21 people that were located right here in New York City, those positions were eliminated and they went to Philadelphia. It's very difficult to monitor a program from Philadelphia when you don't know what the properties are and what the addresses represent.

Chairwoman KELLY. Mr. Czerwinski in a June, 1999 GAO report, the 1997 anticipated losses for the Section 203(k) program were projected to be about $11 million. As a result of hasty reforms and resources being diverted to public relations efforts in this figure, this figure ballooned to $130 million in 2001. If a HUD senior management had heeded the IG's recommendations with regard to problems with the Section 203(k), couldn't the cost to taxpayers be significantly reduced?

Mr. CZERWINSKI. Yes, Madam Chairwoman, the IG had definite recommendations and following them would have cut back on losses.

Chairwoman KELLY. In listening to you I find it interesting that a Cuomo spokesman had stated that the GAO found HUD one of the best-run agencies of the Clinton Administration. Do you agree with that claim?

Mr. RANGEL. I don't think you really want to go there.

Chairwoman KELLY. Answer the question, please, Mr. Czerwinski.

Mr. CZERWINSKI. I think I have advice of counsel. But in all seriousness, I wish it were so that HUD were one of the best run agencies. HUD has made progress, primarily in the area of its reorganization and the area of accountability. However, they need the resources to proceed to the next step, they need the resources to have the right number of people with the right skills in the right places. Information, the information systems to help these people do their jobs, and of course with the cutback in staffing, HUD has relied more on contractors. They need to have greater oversight of contractors to reach that level that we'd like to see them at.

Chairwoman KELLY. Mr. Czerwinski, you thought I would let you get by with that question. I'm going to ask you again. Do you think, do you agree with the claim that the GAO found HUD was one of the best run agencies in the Clinton Administration?

Mr. CZERWINSKI. We have not issued a report that said HUD was one of the best run agencies in the Clinton Administration.

Chairwoman KELLY. You have not issued that kind of report?

Mr. CZERWINSKI. We did not issue that report.

Chairwoman KELLY. That's all I wanted to find out, because I've heard that.

Secretary Weicher, has HUD taken the necessary steps to diminish HUD's focus on media relations and insure that adequate certified oversight staff are in place to properly now review the Section 203(k) loans?

Mr. WEICHER. Well, Chairwoman Kelly, the Department is completing the process that we call the Resource Estimation and Allocation Process to determine where our staff should be employed physically and also programmatically, and this includes not only the Community Builders that you mentioned before, but every other part of the Department. I am myself a member of the task force that is working on this. Our effort is chaired by the Deputy Secretary of HUD. We expect to be making recommendations to the Secretary by the end of this month.

This is a major effort by the Department to consider how our resources should be allocated so that we are able to do the job as well as we can with the resources we have.

With respect to specific activities, we have increased the number of lender monitors that we have from 23 a couple of years ago, to 140 today. We have put contracts in place to analyze what kind of appraisals we are getting on the Section 203(k) program to desktop reviews of the loans as they are originated. In Mr. Czerwinski's testimony, he listed four recommendations that GAO had made and said that we implemented three of them and are in the process of implementing a fourth. On that fourth one, we have selected a contractor, and we expect to have that contract signed before the end of the fiscal year.

Chairwoman KELLY. Could you just tell me a little bit more about what you're doing about the problems created by the community builders program and how you're going to improve the oversight of housing? These people need some assurance.

Mr. WEICHER. What we do with the Community Builders is part of this process that I mentioned. We are revisiting the entire management and staffing of the Department. I would like to be specific, Chairwoman Kelly, but I really cannot, because we are in the middle of making recommendations to the Secretary. The Department will speak with his voice on the subject when it speaks, and that will not be very far from now. But I cannot do it today.

Chairwoman KELLY. I appreciate that. Thank you, Mr. Weicher. I have no more questions at this point.

We'll turn now to Mr. Rangel.

Mr. RANGEL. Thank you so much, Madam Chairwoman. Let me thank this panel for the positive testimony that you've given, and I'm encouraged by the fact that it's our responsibility as public servants to find out what went wrong, what we've got to do to correct it and how we can move forward. I'm certain that we just don't have enough time to share with the General Office of Accounting all of the things that the Clinton Administration is proud of, but I think you would agree with me that that time has come and gone and now we have to move forward.

I would want to make it clear that the not-for-profits and the church groups that were involved in this, do you know whether any of them were in the Harlem community, among those that were indicted, those that were investigated? If so, I would want them named, because the testimony was rather broad in terms of who was victimized, but a little less specific in terms of the conspirators.

Mr. GROVES. You'd like to know the names of the 13—I can talk about the case we have here.

Mr. RANGEL. I'm talking about the names of not-for-profit community-based organizations that were involved as conspirators. Do you have any from the Harlem community?

Mr. GROVES. No, sir, there were none from Harlem.

Mr. RANGEL. Well, I wish that had been stressed, because to us in Harlem, it's very, very important that no matter where wrongdoing is, that we identify it, and since we have been the victims, we want to join with you in seeking out how we can be more cooperative involving the conspirators.

Mr. Weicher, you have a long reputation of doing good work for our Government. I want to thank you for the cooperation that your office has given not only to our community people, but more specifically, to those at HPD, and Fannie Mae and all of the agencies.

Do you think, we should list the names of the criminal people who give Government a bad name, we don't see it listed in the newspapers. Could you provide the names of all of the people that were involved in this scam, and what percentage of them do you think, roughly, have been indicted? Do we still have a lot of people out there?

Mr. GROVES. In this particular scam, none have been indicted. There have been 33 arrests and are charged, not through indictment, through criminal complaint. 19 of those have pled guilty and are cooperating in an ongoing investigation. Because it is still ongoing, I'm not at liberty to name all of the individuals at this time.

Mr. RANGEL. But those who are arrested, that's hardly a private thing?

Mr. GROVES. I don't have those who were arrested, the list of that for you.

Mr. RANGEL. You can get that, can't you?

Mr. GROVES. We did have press releases in the New York area that had them.

Mr. RANGEL. But you could provide that to me of the names of the people that were involved that caused this damage to this good program.

Mr. GROVES. Yes.

Mr. RANGEL. Now, in your IG report, I assume that you had an opportunity before you reached your conclusion to talk with some of these senior HUD officials that the Chairlady refers to so often, have you not?

Mr. GROVES. We have ongoing discussions with the current Administration.

Mr. RANGEL. Not the current, we all have that, we're very pleased with it, but the Chairlady seems to be concerned with the past Cuomo senior HUD officials, the past Clinton-Gore officials. I want to know whether or not you, since you gave the report, had the chance to talk with any of these high-ranking HUD officials?

Mr. GROVES. Personally, I have not. However, we have had a number of audits which cover these areas. We've had exit conferences with those individuals, so there have been discussions between the IG and HUD staff.

Mr. RANGEL. Guess what, I haven't had any discussions with them, either, but you and I would be better informed, I would think, if both you and I had had discussions with them or, in the alternative, wouldn't you agree, that had these high ranking HUD political officials been invited to attend the meeting, we might have a clearer view as to what occurred, so that we could avoid those pitfalls, wouldn't you agree, Mr. Groves?

Mr. GROVES. Communication is best.

Mr. RANGEL. That's a yes.

Chairwoman KELLY. If the gentleman would yield?

Mr. RANGEL. Be glad to.

Chairwoman KELLY. I think it's important that we hear from witnesses who can correct a problem, rather than just going through something that occurred in the past.

Mr. RANGEL. Well, I guess that ends the Cuomo inquiries. I want to thank the Chair and withdraw my question. Thank you all very much. I'm finished, thank you.

Chairwoman KELLY. Thank you.

We turn now to Congressman Grucci.

Mr. GRUCCI. Thank you, Madam Chairwoman. Sitting here listening to what's been transpiring and seeing those pictures and seeing it firsthand in the community where I live, a range of emotions goes through you. I'm appalled that something like this could happen. I'm angry that this has happened, that we've wasted millions and millions of taxpayers' dollars on a program that was designed to give people a quality of life, to improve their quality of life and we've watched that money be squandered.

My question really isn't in the past, it's more now toward the future. You know, I come from a small town, about 450,000 people, small compared certainly to here in New York City. I was a supervisor of that town and I was responsible for spending and investing the taxpayers' money, and we did a lot of things where we used taxpayers' money to acquire real estate and to improve the quality of life for people, but before we did that, we got a number of appraisals and did background checks on them to see if they were truly legit. We didn't take a desk audit, we did field audits. We've looked at the past properties they appraised, we saw if their numbers were accurate. We looked at the lenders, we made sure the lenders have the capability, the background, the ability to do the job they were being asked to do on behalf of the taxpayers, to be a partner with the taxpayers.

I'm gathering that there isn't any of that that takes place and once the barn door is open and the horse has left, it's very hard to bring it back in again. What I want to know is what are we doing to insure that these unscrupulous type of mortgage brokers and appraisers and lenders aren't out there going to continue to prey upon the innocent taxpayers, because we're back, we're fixing what was done in the past. I want to know what kind of policies we're going to be putting in place from this day forward so that this doesn't happen again. We can't fix the inequities of the past, we can't fix whether or not an Administration was right or wrong in their approach to it, but what we can fix is where we going.

Let me start I guess with, I'm sorry, I'm terrible with the pronunciation of names.

Mr. CZERWINSKI. Then it must be me.

Mr. GRUCCI. Czerwinski, yes. Probably the most difficult names I have to pronounce are Italian names and you would think that an Italian should be able to pronounce Italian names.

But that being said, what do you do before we give away the taxpayers' money like this?

Mr. CZERWINSKI. First of all, the comment you made, I couldn't have written them better for you. The key is approving people who will do a good job. You look at the players involved where the risk is greatest; lenders, appraisers, consultants, non-profits. You try to only let the good ones in the door. Then once they're there, you have monitoring of them, because there are incentives, even good ones can go bad or make mistakes. When you do find a problem, you have to act on it, otherwise, you have no teeth.

The key to Section 203(k) is you can't look at everybody indiscriminately, you have to target, and this is where HUD has a real challenge facing it. It needs to have the information that helps it target and that's really requiring the information systems to be upgraded so they can find out which lenders, which appraisers, what's the profile of the problems. Then, of course, you have to have the staff, the skill to deal with them and that's a real issue to be found.

Mr. GRUCCI. Excuse me for interrupting you, but what policies were in place to try and prevent this, and what do you see needs to be fixed in order to fix the problem going forward?

Mr. CZERWINSKI. HUD had policies to approve, monitor and to enforce. It was a matter of implementing the policies, the will to do it, the ability to do it, the resources to do it, and that's where we see it needs to be fixed. There has to be the commitment to spend the time and money there, and have the people who can do this work. Two or three key loans are hard to judge, so you want to have people with skills to go back and check the appraiser's work, who understand the lending underwriting capabilities, for example. You have to have information they can do that with.

Of course with the downsizing of HUD, they rely more and more on contractors, you need an oversight infrastructure for your contractors to make sure they're doing it.

Mr. GRUCCI. Let me ask you a question: I want to participate in the program and I bring you an appraisal. What do you do with that appraisal?

Mr. CZERWINSKI. First of all, you don't go to HUD, you go to a lender that's approved to make Section 203(k) loans.

Mr. GRUCCI. Approved by?

Mr. CZERWINSKI. HUD.

Mr. GRUCCI. How does HUD approve them?

Mr. CZERWINSKI. Mr. Weicher can answer that question better than I could.

Mr. GRUCCI. Let me stop you and ask Mr. Weicher.

Mr. WEICHER. We do several things, Mr. Grucci. We approve lenders based on their record in other programs. Section 203(k) is a very small program. It is 1 percent of our business annually. There are a fairly small number of lenders who actually do FHA Section 203(k) loans, because they are, as we have all been saying, complicated and risky.

Mr. GRUCCI. How do you qualify to be a lender?

Mr. WEICHER. You qualify to be an FHA approved lender in general, based on your net worth, your having a business plan, and your understanding of FHA's requirements. We have 11,000 mortgagees, 11,000 lenders approved to do business with us nationally. We monitor the lenders; we monitor the loans closely, by lender. If we have a fraud problem, we are going to see it within a year of the origination of loans.

Mr. GRUCCI. Are your lenders recognized lending institutions?

Mr. WEICHER. Oh, yes, we have nearly every commercial bank, every community bank in the country, and mortgage bankers. They are recognized organizations.

Mr. GRUCCI. Then not a consortium of wealthy individuals who come together and qualify to be a lender?

Mr. WEICHER. I think they would have to first qualify to be a bank before they qualify to be a lender or a mortgage banker. It would be possible for a wealthy individual to establish an entity which would qualify, but you would have to establish the entity. We do not have—we would not have—a millionaire who is an individual in our programs.

Mr. GRUCCI. My time is expiring.

Chairwoman KELLY. Your time is expired.

Mr. GRUCCI. It has expired. It's never good to have your time expire. I'm going to follow up with written questions, because there's a lot more I need answers to.

Madam Chairwoman.

Chairwoman KELLY. Thank you very much. I will note that obviously, we three are very interested, and some of us may have additional questions for this panel and for other panels, and you may wish to submit them in writing. So without objection, the hearing record will remain open for 30 days for Members to submit written questions to these witnesses and to place their responses in the record.

The first panel is excused with our great good thanks. We appreciate your testimony and thank you very much.

Mr. RANGEL. Let me join in thanking them and assure you that I look forward to working with you to get some positive solutions to this very serious problem. Thank you all very much.

Chairwoman KELLY. Will people who are having conversations either please leave the room or stop the conversations.

I want to thank the new people that are coming in front of me. The second panel, we're glad to have you here. You are interesting people we want to hear from. As I understand it, you've all been victims.

Before us, we have Mr. Brett and Mrs. Marla Renwick. Miss Wilma Foncette. And Ms. Glorie Browne. All four of you, as I understand it, you're area residents or would like to be residents in this area, and you were affected by the fraud and mismanagement in the Section 203(k) program that has affected Harlem so badly. The Renwicks and Miss Foncette tried to purchase homes in Harlem, while Ms. Browne was a tenant in a Harlem brownstone that was victim to a phony transaction.

You're all witnesses to this hearing, and when doing so, the Chairwoman may decide to take the testimony under oath. Do any of you have any objections to that?

PANEL. No.

Chairwoman KELLY. All right, I now will advise you, the Chair advises you, that under the rules of the House and the rules of the Committee, you are entitled to be advised by counsel. Do any of you desire to be advised by counsel during your testimony today?

PANEL. No.

Chairwoman KELLY. Thank you. In that case, will you all please rise and raise your right hand?

[Witnesses sworn.]

Chairwoman KELLY. Thank you very much. All of you are now under oath. Without objection, your written statements will be made part of the record. You each will now be recognized to give a 5-minute summary of your testimony. Prior to my saying that, my beginning the testimony, I want to simply say that this subcommittee will be following up and will talk to former Cuomo HUD staff and will ask them to explain Secretary Cuomo's decision-making process.

We will also allow people if they have been victimized by the Section 203(k) program, we will accept written testimony from anyone who feels they would like to write to this Committee. So you have 30 days in which to get that done.

We will begin with you, Mr. Renwick.

Mr. RANGEL. May I also welcome the witnesses? Since you're from my community, I think I have a unique responsibility to make certain that our job is not just to find out what went wrong, but to try to make you whole in what you've done, because you have decided to invest and to live in a community that's given a lot of hope. And if we can identify any wrongdoers that have shattered that hope, our job is to restore that hope and to make you whole and do all we can, not just to find out what went wrong, but what we can do to make things right.

So while the Chairlady may be spending a lot of her time dealing with former HUD officials, I'll be spending most of my time dealing with current HUD officials to see how we can make you whole. It takes a lot of courage to come out publicly to state your personal setbacks, but I want you to know that whether Republican or Democrats, we have a responsibility to help you, and I thank you for taking this time out to help yourselves and other people by sharing your experiences with us. Thank you so much.

Chairwoman KELLY. I thank you, Congressman Rangel, and I also want to point out we're having a hearing to try to correct this situation. We don't want people to be victims of this program.

Let's begin with you, Mr. Renwick.

STATEMENT OF MR. AND MRS. BRETT RENWICK, SECTION 203(K) LOAN APPLICANTS

Mr. RENWICK. Members of the subcommittee, good morning. This is my wife, Marla. Thank you for this opportunity to chronicle our experience with HUD's Section 203(k) of the National Housing Act, while attempting to purchase a brownstone in the Mount Morris section of Harlem.

After looking for a brownstone for 13 months, our agent at the Charles Greenthal agency told us of a brownstone at 148 West 121st Street that was available. We placed a bid and it was accepted. After signing a contract, our lawyer conducted a title serve via the Liberty Title Agency and once the title was proven clean, instructed us to have our architect begin work on the plans for our new home.

Weeks later, our lawyer in the course of a routine conversation with the seller's attorney, was told that certain previous owners of this property were in the process of being indicted and that there was additional debt. My lawyer reviewed the title search she conducted and found no mention of this. She informed us that in the instance of an unrecorded event having taken place, it was referred to as a "cloud on the title." Despite my urging, she told us to wait and did not arrange for closing in spite of the title insurance she had attained.

Over ensuing months the fact came into view. On October 28, 1999, Thomas Star sold this brownstone to Beulah Church of God in Christ Jesus Incorporated in Brooklyn and allegedly made some sort of financial arrangement with their title company representative to not register the sale of this property. This meant that although Beulah, who used Section 203(k) to purchase this and 25 other brownstones, had paid for this property, it would not appear on the City Register as it was supposed to 5 days later. Soon after this, Mr. Star sold the same property to a not-for-profit for $10,000. Mr. Johnson, as the head of this not-for-profit called Shelter House Corporation agreed to sell the property to my wife and I.

The current name of the title company in question is Stewart Title. My lawyer obtained a letter from Stewart Title to the seller's attorney dated September 14 stating that, and I quote: "Our agent neglected to record the deed," and that they would rectify this problem.

They did, and provided the title, thereby making Beulah owner of record. My wife and I had the down payment returned to us, but already spent $15,000 in architectural, legal and other fees and still owe our architect $3,500 for services rendered. Nearly 7 months later, my wife and I were tired of trying to deal with Stewart Title, the seller's attorney—the seller had disappeared—and HUD. HUD took no responsibility for the program which bears its name and told us they would do nothing.

Soon after this we met with Darren Walker, the COO of the Abyssinian Development Corporation, who had been asked by the departing head of HUD, Andrew Cuomo, to help clean up the mess in Harlem. Darren assured us that HUD, who now referred to my wife and I as "the *New York Times* people," because we had been featured in an article, wanted to make good and get us the property. After spending hours upon hours with HUD representatives in both New York and DC offices repeating the same information over and over again, nothing happened. HUD dismissed Abyssinian and I was instructed to keep in touch with Peter Spina of HUD in the New York City office.

Months passed and my bimonthly calls ended the same each time. HUD was aware of our predicament, and wanted to help, but could do nothing although they promised us the house. Finally, after hearing this too many times, I wrote the secretary of HUD, Mel Martinez, a detailed letter asking for a date for HUD's intervention and a date when my wife and I could purchase this property.

His response came in the form of a generic letter from Ingram Lloyd, Director of HUD Homeownership Center in Philadelphia, who had no knowledge of our case. In addition, I received a phone call from Ms. Ford who insisted that HUD was a third party with absolutely no ability to influence the outcome of any property deemed contested. She also stated that HUD would make no promises to us and that she would respond to my letter in kind, which never happened.

It is our contention that had HUD held tighter reigns over this program there would be some sort of apparatus in place to identify, label and administrate Section 203(k) properties once they had been sold. Our experience in dealing with HUD is that of a disinterested bureaucratic organization that refuses to take responsibility for a program it has written the rules for. Had HUD done its job, someone from the agency would have seen that Beulah had not renovated the property. That never happened. Approved HUD lenders like Brucha Mortgage Bankers Corporation, the mortgage lender Beulah secured the funding from, and M&T Mortgage Company, who facilitated the transaction under HUD's own rules should never have released the $401,375 to Beulah prior to work on the property commencing. Beulah is in default of its obligation, among other defaults, and failure to make monthly payments on or after December 1, 1999.

Our proposed remedies are as follows: A HUD representative should be compelled to attend every property closing where the seller is securing a HUD-backed loan of any type. This representative should also be required to do followup, which involves making sure the sale is recorded correctly and a sales freeze is imposed on the property, avoiding any flipping by the owner for a period of at least one year.

Since HUD refuses to sell properties directly to well-meaning individuals like my wife and myself, choosing to sell properties to anyone off the street willing to purchase several buildings and calling themselves either a developer or not-for-profit, the onus should be on the agency to check the credibility of each potential buyer thoroughly and document the construction process.

At this point in time, every city agency works against, not for, prospective home buyers like my wife and myself. The building department holds up purchases with ridiculous paperwork like changing the certificate of occupancy from a SRO to a four-family, having to obtain a certificate of nonharassment, and ADA compliance in regard to owners building disabled access and bathrooms for able-bodied owner's units. In spite of everything, my wife and I still want to purchase, renovate and live in that brownstone on 121st Street.

In closing, I'd like to thank the subcommittee for the opportunity to tell the story that has caused my wife and I an enormous amount of emotion grief and financial expense, but wonder what any of you will do in our behalf.

Thank you.

[The prepared statement of Brett Renwick can be found on page 69 in the appendix.]

Chairwoman KELLY. Thank you, very much. Mr. Renwick.

Now we go to Miss Wilma Foncette. Will you please pull the microphone before you and tell us your story.

STATEMENT OF MS. WILMA FONCETTE, SECTION 203(K) LOAN APPLICANT

Ms. FONCETTE. Well, I bid on this house on 118th Street, I don't remember what date. And it was, the agency came and took us around the real estate, we had a lawyer. Everything went smooth, until the day that we were closing. We went to the table, everything was transferred, everything, just waiting for the OK, when all of a sudden, we were told to get out of the building and the two men were arrested. They gave us the money back, but it was months afterwards we got the money back. But we would still like to live in the building, if it is available, we would like to have it.

[The prepared statement of Ms. Wilma Foncette can be found on page 73 in the appendix.]

Chairwoman KELLY. Is that the end of your statement?

Ms. FONCETTE. Short and sweet.

Mr. GRUCCI. That's a rarity.

Chairwoman KELLY. That's great. I thank you very much. If I understood you correctly, that the men came and arrested the sellers' lawyer and——

Ms. FONCETTE. Himself.

Chairwoman KELLY. The both of them, while you were in the process of closing.

Ms. FONCETTE. Yes, while we were in the process.

Chairwoman KELLY. Thank you. Thank you very much.

Next we go to Ms. Glorie Browne.

STATEMENT OF MS. GLORIE BROWNE, SECTION 203(K) BUILDING TENANT

Ms. BROWNE. Good morning, Members of the subcommittee, invited guests, tenants of the Section 203(k) buildings and others. Thank you for providing me with the opportunity to address you this morning. My name is Glorie Browne, I live at 74 West 131st Street here in Harlem. My building is a brownstone rooming house with 13 single room occupancy units, very typical of the vast majority of the Harlem buildings in the Section 203(k) program. I have lived there for about 10 years.

I am here in solidarity with all of my fellow Section 203(k) neighbors. I am also a tenant in a Section 203(k) building who has suffered through the injustice of a housing scandal that had nothing to do with housing. It had to do with unscrupulous landlords and money hungry non-profits that saw opportunities for quick money in buying our buildings, then abandoning them and allowing them to rot.

They defrauded a Federal loan program and they also committed fraud against unsuspecting tenants like me. Not only did their crimes leave us without responsible landlords, it also left us with no heat and hot water last winter, leaky ceilings, damaged walls, broken boilers, shaky building infrastructures and no hope. Up to 2 years after the news of this scandal broke, some tenants are still without basic services.

About 200 brownstones in Harlem are caught up in this mess. About 160 of those buildings, about 85 percent, are SRO rooming houses that should never have been in the program to begin with. Around 65 of those buildings are currently occupied by as many as 600 tenants. My story is similar to many Section 203(k) tenants stories. My building has never been a palace, but my neighbors and I call it home.

After the so-called non-profit Beulah Church of God bought the building in 1999, my neighbors and I found ourselves without heat and other basic services. In fact, the first act of the new owners was to shut down the boiler in the middle of winter. When we finally went to court to force Beulah to maintain the building, no one from the landlord showed up and the court order we got ordering the landlord to make repairs was never complied with. For over a year there was no garbage pickup, no repairs made to the very leaky skylight or the broken pipes or the uneven front steps. The gas and electricity were shut off at least once and the water was shut off a few times, forcing my neighbors and me to wash with bottled water.

An inspection last year found 94 violations of the city's housing maintenance code in the public areas alone.

The landlords that committed these crimes are using HUD loan monies, money that was supposed to go into rehabilitating buildings. Instead, the money disappeared along with the landlords. Now, as the scandal continues to unravel, we tenants are bearing this huge burden. HUD has finally agreed to take responsibility for maintaining many of the occupied buildings in the program, while others, like mine, have gone to court to get an administrator appointed by the city to run the buildings.

What we are most worried about now is the threat that the new owners, whether they are private owner-occupiers, not-for-profit groups or entrepreneurs looking for properties to flip, may try to displace the existing tenants from our buildings or to raise rents beyond what we can afford.

But my intention today is not to tell the story of hopelessness, no. I'm here as a representative of Section 203(k) tenants with a strong message of hope and self determination. We are survivors. We're long-standing Harlem tenants ready to reclaim our homes and our community. We're speaking out for the preservation of affordable housing in Harlem. We're standing up for preservation of our homes and we demand to be included in any discussions about their future. We demand full repairs and services in our buildings now. We want legally-enforced assurances from HUD, the city's Department of Housing Preservation and Development and other appropriate parties that no tenant will be displaced when the buildings are finally disposed of. We want guarantees of affordable rents and we want substantial opportunities to explore the possibility of bringing some of our buildings under tenant ownership and/or control through mutual housing associations, limited equity co-ops or other mechanisms for tenant involvement.

Our demands are not unique. They are demands of many low-income tenants in the city. I am here as a spokesperson for the Section 203(k) tenants and we say we'll do everything we must in order to save our homes. We are here to stay.

Thank you, and God bless you all.

[The prepared statement of Ms. Glorie Browne can be found on page 79 in the appendix.]

Chairwoman KELLY. That was eloquent testimony, and Miss Browne, you brought something out that I think is very important, that you're here representing a group of people. Just for the record, I would like to know how many people in this room, if you would be good enough, the witnesses can stay seated, how many people in this room have been victimized by the Section 203(k) program. Would you stand for me, please?

All right, thank you very much. I appreciate that. There were several people in the back that I saw that I know were also victimized. We want you to stay in Harlem, it's a beautiful place to live, we'll do what we can to help you.

In some of the reports the committee examined, we read of all these faulty repairs that were made to the Section 203(k) properties that were dangerous to the tenants. Are you familiar, Miss Browne, with any instances of repairs leaving exposed wires or faulty plumbing?

Ms. BROWNE. Not in the building that I live in.

Chairwoman KELLY. Are you aware of others?

Ms. BROWNE. Yes.

Chairwoman KELLY. Are you aware of anyone who has ever been physically injured living in one of these Section 203(k) buildings?

Ms. BROWNE. Not to my knowledge, but I would say there could have been injuries to someone, because the building didn't have lighting in the hallway. When they had their lights cut off for 8 days, any could have been injured. We didn't have water, running water.

Chairwoman KELLY. You didn't have water in your building either?

Ms. BROWNE. A couple of times they had to cut it off.

Chairwoman KELLY. How long did you have to go without heat?

Ms. BROWNE. In 1999, that winter, starting from the like November until the winter ended, we didn't have heat and hot water.

Chairwoman KELLY. You mentioned you're aware of tenants who didn't have heat and hot water in your building?

Ms. BROWNE. Not my building, other buildings.

Chairwoman KELLY. That you're aware of, there are still people without heat or hot water living in these Section 203(k) buildings?

Ms. BROWNE. Yes.

Chairwoman KELLY. If the landlord didn't show up, how do they pay the rent?

Ms. BROWNE. They do what we did, put it into an SRO account, that's what we did. But HUD came in.

Chairwoman KELLY. So HUD came in recently and have been working with you to correct the problem?

Ms. BROWNE. What we did, meeting with SRO Law Association in Harlem, having tenant meetings, being aware of these other buildings and conditions they live in. We also visited a few buildings to see the conditions.

Chairwoman KELLY. Have you ever seen a representative of your current landlord or have you ever seen your current landlord?

Ms. BROWNE. Right now, the one that I have? We have a 78 administrator, I've seen him.

Chairwoman KELLY. You have what?

Ms. BROWNE. A 78 administrator. I've seen him.

Chairwoman KELLY. But that's not the person who let it go back. You have a 78 administrator, did you ever see your landlord?

Ms. BROWNE. The person who represented the Beulah Church of God and Christ came once. But then we didn't see him.

Chairwoman KELLY. He came once and you then didn't see him again.

Ms. BROWNE. When you call his office you get a machine and he never returns the calls.

Chairwoman KELLY. I thank you very much. I have no more questions of this panel.

Mr. RANGEL. I can't thank you enough, because you have, you didn't have to come to Harlem, you didn't have to stay in Harlem, and if we can't protect those that anchor their hopes and dreams in our community, then it makes it even more difficult for those that come to communities that are less fortunate than we are. As a result of this fraud that has happened, we will be working closely with the Abyssinian Development Corporation and the West Side Employees to put together a legislative team of our City Council officials, but also the District Attorney's office, the Attorney General, this won't be of much help to you, but your testimony means that we have to make certain this doesn't happen again.

What we're doing that relates directly to what you want is joining with HPD to make certain that we get the money that's necessary to avoid these properties just going off to speculators and having the Federal Government just put them in default. And so I hope that you work very closely with my office to see that in some way, through you, we'll be able to say that we put this program on the right tracks and I'm certain in working with Congresswoman Sue Kelly that if we can make certain that in New York State we got it back on track, we can avoid this same type of thing happening in other states and other communities, so I can't thank you enough.

I regret what has happened, but I thank you for having the courage to come forward and testify with such eloquent testimony. Thank you.

Chairwoman KELLY. Thank you.

Mr. Grucci.

Mr. GRUCCI. I don't have any questions of this panel. I think they've been victimized and certainly it's a demonstration of a failed program, a failed policy and a lack of oversight and it goes back to my questions earlier of the first panel. We want to make sure that this doesn't happen again.

I thank you, too, for making a commitment to your community. The Congressman said it very eloquently, that it is important that people want to make a commitment to a community, because that's what a community is really about, it's about people coming together and improving the quality of life. And Government ought to help that to happen, not hurt it, or be an obstacle in its way. I feel compelled to apologize for a system that has failed you, and to that extent we recognize that it needs to be fixed. It is indeed, broken. Thank you for being here this morning.

Chairwoman KELLY. I want to add my thanks. Mr. Grucci is a Member of my subcommittee. You can be assured that the two of us will work with Charlie, since he represents this area, to make sure that we get this system fixed, and I really appreciate your coming forward.

We hope, too, that you will be able soon to be able to get through this system what you needed and be able to live here comfortably in Harlem. So thank you very much. I want to remind you that some Members will perhaps have written questions. I will hold the hearing record open for 30 days, so there may be written questions. That being said, we thank you very much, and we will excuse you.

Thank you.

I'd like to have the third panel take their places.

Chairwoman KELLY. Will people take their conversations outside, please, so we can convene this panel.

I'd like to begin the introductions by welcoming some community leaders who have witnessed problems with the Section 203(k) program in their neighborhoods and they're promoting proposals to redirect and reorganize the program. So we welcome today, Mr.

Ruben Medina, a former Vice President of PaineWebber who has had great success as a hospital and health facility consultant and executive. He now leads Promesa's efforts to assist the minority and poor in the Bronx in a variety of ways, such as owning, rehabilitating and managing housing.

Next we will hear from Ms. Karen Phillips, Cofounding President and Chief Executive Officer of Abyssinian Development Corporation, one of the not-for-profit corporations that's most active in the Harlem Renaissance and in an effort to change the direction of the FHA Section 203(k) program here in Harlem. Ms. Phillips has guided the agency in developing hundreds of units of housing and fostering business development here in Harlem.

Third we'll hear from Ms. Lydia Tom, Senior Program Director of New York City for Housing and Finance for the Enterprise Foundation, which works nationwide to build affordable housing, and became the first non-profit organization to build 100,000 homes for low-income families. For the last 7 years she has been providing assistance to community non-profits and entrepreneurs by guiding them through the specifics of financing, city regulations and Federal funding.

We'll then hear from Jerilyn Perine, Commissioner for New York City Housing Preservation and Development. It's the largest municipal housing agency in the United States. Ms. Perine has been involved in urban planning and housing issues during her entire career. She is a long-time senior official at NYHPD and also has been also very active in seeking a consensus solution to the riptide caused by the Section 203(k) scandal.

You are all aware that the subcommittee is holding an investigative hearing and when doing so, the Chair may decide to take testimony under oath. Do any of you have any objection to testifying under oath?

PANEL. No.

Chairwoman KELLY. I then will advise you that each of you under the rules of the House and the rules of the Committee, you are entitled to be advised by counsel. Do any of you desire to be advised by counsel during your testimony today?

PANEL. No.

Chairwoman KELLY. In that case, if you all please rise and raise your right hands, I'll swear you all in.

[Witness sworn.]

Chairwoman KELLY. Thank you very much, you are now under oath. Without objection, your written statements will be made part of the record. You will each now be recognized to give a 5-minute summary of your testimony and we'll begin with you, Mr. Medina.

Mr. RANGEL. Madam Chairwoman, might I greet the people? Because this panel really is a part of the solution and we'll find out what went wrong and we'll have to get it on track.

I want to thank you for what you have done, but also to tell you you have partners with us and the City Council and the State Legislature and certainly with myself and Mrs. Kelly in the Congress. It seems to me what we have to do is not only to avoid this happening, but to make the victims whole. We need about $160 million. I understand that HPD is negotiating, I hope in a positive way, with HUD. What is just as important, is that HPD not be a substitute for the community, but be partners with the community and collectively we work together, the same thing would apply to Mr. Medina. So our Councilman Bill Perkins, local officials are partners with you, so you don't have the whole burden of removing this terrible tragedy from our community, but we'll be doing it together and we'll be partners with you.

Thank you so much for the opportunity.

Chairwoman KELLY. Thank you very much.

Mr. Grucci, would you like to say anything at this time?

Mr. GRUCCI. No, I'll reserve my comments for later.

Chairwoman KELLY. Thank you, then let's begin with you, Mr. Medina.

STATEMENT OF RUBEN MEDINA, CHIEF EXECUTIVE OFFICER, PROMESA SYSTEMS, INC.

Mr. MEDINA. Thank you very much, Madam Chairwoman, and Congressman Rangel and Congressman Grucci.

Promesa Systems is a Community Development Corporation serving clients in the areas of health, housing, education and economic development, and in that regard, through concessions with HUD, it came to Promesa's attention that a significant number of buildings, primarily located in Harlem and Brooklyn under the Section 203(k) program were actually SROs—single resident occupancy buildings. Promesa was also told that under the guidelines established by the Section 203(k) program, these buildings never should have qualified and could never actually be operated under the Section 203(k) program.

Finally, Promesa was informed that the SROs had residents that could never qualify, really, as homeowners, and added a significant number of social health issues that needed to be addressed; potential substance abuse, mental health conditions and conditions of substantial concern to its population.

Promesa would like to explore the use of HUD's existing SRO stock in the Section 203(k) program to address the needs of the existing population and perhaps better utilize potential capacity for additional population. Specifically, Promesa proposes to take the housing stock that fits in the SRO category of and geographically convoluted villages of these types of units. These villages would then have a number of community-based organizations and development corporations organized into a form of joint venture which would promote renovation, property management, mental health, physical health along with any other social services and issues necessary to support residents. The form of joint venture could provide the basis for stabilization and protection of the resident population of the SROs.

In order to guarantee logistical flexibility reflection and diversification of risk, Promesa proposes conversion converting these villages into formal corporations consisting of 15 to 20 buildings, such that the joint venture can use the inherent value of the properties to provide the basis for recapitalization and renovation. Recognizing that on average the structures are half occupied, critical mass is needed if repairs and renovations are to be made to the units in a timely manner. Although it is our understanding that very few tenants have accepted the offer to relocate permanently, chances are good they would relocate temporarily if they knew they could come back to their place of living after the renovation.

Also Promesa has not had the opportunity to evaluate the buildings, it is its expectation that some percentage of the individual units can be renovated and marketed at or close to market rates. Use of the combination of grants, tax exempt financing, investment tax credits can offset the cost of renovating the building and units. The combination of the above subsidization, along with mentioned rental income, can create a viable approach for the villages. Clearly the current value of many of these properties will not be close to the actual investment made under the Section 203(k) program. Further future cash flow is based upon existing population, it most likely cannot support the initial value plus the probable cost of renovations. Further, to place constraints on investors regarding the need to protect existing residents would lower the prospective value even more so.

Chances are good then that vending out the properties will not result in the recoupment of much if any at all of the initial investment made by the initial investors and guaranteed by HUD.

While the financial investment made by banks and guaranteed by HUD may never be recouped, perhaps some minor partial compensation can be accomplished over time through future cash flow as a result of the combination of future rental income and service. Another approach might be to charge a flexible transaction fee as parts of the right to manage these buildings after transfer. These approaches could be acceptable to both organizations involved in the community development and delivery of services to the population as well as to the residents and the investors. In this manner, the residents of SROs are not packed off into the night because of gentrification of all of a sudden accessible real estate, nor are they victims of benign neglect or are called and obstacle to the stabilization and strengthening of the community.

Further, HUD has comfort in that the joint venture is not made up of a single organization that may have good intentions and resources but can veer off the path, but rather a formal conglomeration of organizations that participate in the decision of the operations. By giving the residents representation themselves on the governance body, one is assured of the buy-in by the residents. HUD has had some positive experiences with this at Diego Beekman Houses in the Bronx.

Based on earlier testimony, it appears that HPD has, in fact, certain working relationships with HUD in terms of Section 203(k) programming. We are very much in support of that considering they do have specifically for SROs a supportive housing unit structure. So with that, I'd like to conclude my testimony and thank you very much for the opportunity.

[The prepared statement of Ruben Medina can be found on page 81 in the appendix.]

Chairwoman KELLY. Thank you very much, Mr. Medina.

Next we turn to Ms. Philips.

STATEMENT OF KAREN A. PHILLIPS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, ABYSSINIAN DEVELOPMENT CORPORATION

Ms. PHILLIPS. Thank you very much, Chairwoman Kelly, for bringing this subcommittee hearing to the Village of Harlem. It underscores this condition. We thank Congressman Rangel for being here today and Mr. Grucci for joining us.

I would like to summarize some of the comments in my written testimony, basically outlining the history of the program and its impact on our community, but as president and CEO of Abyssinian Development Corporation, I do want to let you know that the potential for this program and the way that we distribute or deal with the problems has a direct impact on the investment that has been made in this community by Abyssinian Development Corporation and a number of community based-organizations that have been working for the past 15 years with a lot of Federal support and thank you all for the low-income tax credit that has been used extensively in this neighborhood to help stabilize the neighborhood so these homeownership opportunities could occur.

However, the success of the non-profit organizations in this neighborhood, and particularly those that are faith based, are part of what was the attraction to this neighborhood to bring in the unscrupulous real estate professionals to prey on this neighborhood and the important part of this is, as I heard the HUD officials' testimony, they all talked about the non-profits who perpetuated this, or who were unknowing suspects to this fraud. The kind of scar that it leaves on the name and the character of the non-profits in this community is still very much present, because when you say faith-based non-profits, we have the Harlem Congregation for Community Improvement working with us, several other churches and institutions, but we are now blamed for something that was really brought to this neighborhood because of our success.

The other particularly troubling part of this is the effect that the Section 203(k) capital had on the real estate market in this community. We and other non-profit organizations as well as private developers have done other homeownership projects and we have just a history of some that we've been involved in in marketing the City Homes Program, which was a City of New York program working with the Enterprise Program and CPC. In 1994, we sold four-story brownstones very similar to the ones that have been talked about here today, for an average price for a three-family home of $115,000. Two years later, we did a second phase of that program where the average home price was $230,000, on some of the same blocks where these houses are located.

Then working with HPDs' Home Works Program, ADC as developer, participated in a program with 33 brownstones, half of whom had been sold already, all of whom had been sold and half had been completed, but those average prices are around $375,000. Those prices were set at 1998 at the same time the fraud was being perpetuated where people were coming in and driving up the prices of a vacant building so that the effective costs, as I heard one of the HUD representatives say, so when the non-profit paid, the building was flipped, so the non-profit paid $220,000, and then the resulting loan, which also would be guaranteed through the Section

203(k) program, was another $300,000, so immediately, the value of that house was considerably higher than what we knew the market to be.

This not only put the price of those homes outside of the people in the community, but the real plan for these non-profits were to have these as rental units. So what they were doing was replacing the whole absentee landlord structure that we came in to kind of heal in our work over the last 15 years. We had downtown real estate interests who saw this activity which was fraudulent in the real estate recordings, and then immediately started coming up to address and try to get other private brownstones and I think there was an article in November of 1999 when they realized that the products that they were looking at were not here for them to sell to their downtown clients who had said look, if I can get a home in Harlem for what I pay for rental, I'll come up and do it, but, because of the Section 203(k) program and these number of buildings, that was a false signal to the real estate market, and those prices now can never really be fixed.

It has also contributed to a considerable panic about gentrification in this neighborhood.

Moving on, I'd like to say that after finding out about the problems that had occurred with the Section 203(k) program, Abyssinian Development Corporation was approached in, I believe, late November-December of 2000 to see if we would assist in trying to remedy the situation that had been caused. Joining with the Community Preservation Corporation, the Enterprise Foundation and the East Brooklyn Congregations, we formed what was called the New York Group and did a memorandum of understanding with the U.S. Department of Housing and Urban Development, to try to formulate a plan which would emphasize the tenants were to initially have affordable homeownership as one and particularly to insure that the people who were living in these buildings would not be dislocated from the community. That plan subsequently, the new Administration did not continue, but we still stand ready in trying to negotiate and help HUD to figure out a way to remedy this situation.

Abyssinian Development Corporation and the New York Group really served to coordinate other non-profits and some of those that we had been meeting with regularly in formulating this plan and to working on some of the problems that we knew were inherent in the occupied buildings were the Harlem Congregation for Community Improvement, Hope Community, Manhattan Valley Management and Development Corporation, West Side Group Assistance, Harlem Community Center, West Side Center for Senior and Progressive Housing, Progressive Maintenance and other groups we knew could be added to provide the kind of input on a local level.

Chairwoman KELLY. Ms. Phillips, I'm sorry to interrupt you, but you're well over the time slot and if you could summarize, I'd greatly appreciate it.

Ms. PHILLIPS. Basically, what we're here to say is we support the involvement of New York City HPD in this process and we through our work in the neighborhood know that funds would have to be made available for them to be affordable housing and we think the majority of the housing should be given to the people in the community as a priority and strong efforts to have these existing not-for-profits to participate in the process of redeveloping them. And not to have them bid out to the highest bidder.

Thank you very much.

[The prepared statement of Karen A. Philips can be found on page 86 in the appendix.]

Chairwoman KELLY. We thank you.

Next we have you, Ms. Tom.

STATEMENT OF LYDIA TOM, SENIOR PROGRAM DIRECTOR, THE ENTERPRISE FOUNDATION

Ms. TOM. Thank you, Chairwoman Kelly, Congressman Rangel, Mr. Israel and Mr. Grucci. Thank you for inviting me to testify.

The Enterprise Foundation is a national intermediary, which has been working to improve living conditions in low-income communities from the time it was founded by visionary real estate developer Jim Rouse in 1982. The Enterprise Foundation operates from the conviction that developing quality affordable housing is an essential first step in a holistic approach to fighting poverty.

Since opening a New York office in 1986, Enterprise Foundation has developed over 11,000 affordable apartments in more than 850 formerly abandoned buildings throughout the Greater metropolitan area. This has resulted in improved living conditions for more than 33,000 people including 13,000 children.

The Enterprise Foundation's work in New York City is done in collaboration with over 80 legitimate non-profits, community-based organizations whose leaders have identified their own neighborhoods' most pressing needs and develop workable strategies for solving their own problems. In addition to our work developing affordable rental housing with our community partners, we also have created opportunities for homeownership for low- and moderate-income families with our visionary CityHome program. Working in collaboration with the New York City Department of Housing Preservation and Development, the Community Preservation Corporation, and a number of community-based non-profits, we've recovered nearly 500 dilapidated properties to the housing market and low-income communities in Harlem, Brooklyn and the Bronx. Our current involvement in low-income homeownership opportunities includes a significant commitment of over $2.2 million in short-term low-interest loans to community-based organizations in collaboration with HPD's Neighborhood Homes Program.

Because the Enterprise Foundation only became involved with the New York City Section 203(k) program after the fraudulent activity had been detected, we cannot comment on that part of the program.

The Enterprise Foundation was approached by HUD in December of last year to help develop a workable solution to the emerging Section 203(k) Program. From our first discussions with HUD, Enterprise raised the importance of working with members of affected communities in moving forward. We also strongly recommended that HUD develop a programmatic approach to rehabilitating the properties in question and returning them to the housing market.

A significant number of affected properties are occupied by existing tenants. Some are single room occupancies, legal and illegal. Efforts to properly manage these homes and ensure affordability and non-displacement without appropriate relocation need to be made for these residents who are victims of the Section 203(k) problem.

Because of our experience with CityHomes and other renovation programs, including occupied rehabilitation, we clearly stated to HUD there exists a number of viable models for working with legitimate non-profits to renovate these properties and market them as homeownership and/or rental opportunities for low- and moderate-income people. From the beginning of our involvement, we urged HUD to see the damage left by Section 203(k) problem as an opportunity to invest in the communities where the properties are located by creating homeownership opportunities. Such opportunities could only reinforce the investment that HUD has already made in these same communities.

Regardless of how HUD wants to proceed, two points remain irrefutable: That further investment would be needed to bring the homes in question up to habitability, that the longer the damaged portfolio remained dormant, the more damage would be done to the investments made to date. It was our recommendation that HUD subsidize all further renovations needed to make the properties habitable, no matter how significant, in order to keep the buildings' eventual sales prices affordable to local residents.

The Enterprise Foundation, CPC and Abyssinian Development Corporation urged HUD to put processes in place to evaluate potential contractors, lenders and prospective buyers and the original Memorandum of Understanding written by Secretary Cuomo detailed specific roles and responsibilities for each organization participating in the solution to this very serious problem. We have shared these same views with the new team at HUD with whom we have worked constructively, including Secretary Martinez and senior HUD officials.

It is Enterprise Foundation's firm conviction that the only viable solution to the Section 203(k) problem involves a holistic and programmatic approach that will impact the long-range fiscal health of the communities involved by continuing to develop opportunities for low- and middle-income homeownership, as well as affordable housing. We further believe that it's HUD responsibility to designate every property and in the portfolio as a low- or middle-income homeownership opportunity. The Section 203(k) program has been designed as a flexible mortgage product to acquire and rehabilitate foreclosed properties for affordable housing. To that end, we find the $80 million currently budgeted by HUD for the rehabilitation is woefully inadequate to the task.

New York City's Department of HPD, the most sophisticated municipal housing agency in the country, with the most experience in rehabilitating and disposing of distressed properties, estimates that it will take $160 million to redevelop the portfolio. We strongly urge HUD to invest in the continued stabilization of these communities by appropriating sufficient funds to maintain the integrity of its previous investment. Because of HPD's vast experience and their current investment in these neighborhoods, we also recommend that HUD work closely with HPD to rehabilitate these properties. Most importantly, we urge HUD to recognize the tremendous expertise of legitimate community-based non-profits such as Abyssinian Development Corporation and East Brooklyn Churches as critical partners in carrying out such a program.

Harlem and Brooklyn's low-income neighborhoods have come a long way in recent years. Their progress has transformed the lives of thousands of working New Yorkers and benefited the entire city, but their success is fragile. For progress to continue, the residents, community groups and private and sector partners that have made it possible must have confidence that their efforts and their hopes for further revitalization will not be eroded by bad practices reminiscent of the unhappy past. Property flipping and rampant real estate speculation could douse the flames of Harlem and Brooklyn's continuing redevelopment. Fixing the Section 203(k) problem in the manner we described will help assure it does not happen and make a positive result to a negative situation.

Thank you for the opportunity to testify.

[The prepared statement of Lydia Tom can be found on page 90 in the appendix.]

Chairwoman KELLY. Thank you very much Ms. Tom.

Next we go to Ms. Perine.

STATEMENT OF JERILYN PERINE, COMMISSIONER, NEW YORK DEPARTMENT OF HOUSING PRESERVATION AND DEVELOPMENT

Ms. PERINE. Thank you. I'd like to start by giving you a brief overview of our agency's functions, because I think it is relevant to the recommendations I will make in my testimony. We're a unique housing agency because we carry out the planning, development and enforcement functions related to housing and community development. Over 68,000 units have been renovated or newly constructed through our program since 1994. In addition, we place a great emphasis on housing preservation through below market loans to owners in need of rehabilitation financing, direct financing and education to owners to help them become better managers. We operate the most extensive housing enforcement system in the country, handling over 300,000 calls a year mostly from tenants and conducting over 200,000 inspections from tenants which resulted last year in 322,000 housing code violations being in place. In addition, since 1994 we've been aggressively returning to private ownership the stock of dilapidated housing that came into city ownership because of tax delinquency located primarily in Harlem, the South Bronx and central Brooklyn. These buildings provided housing for some of our poorest families, but were typically in the worst condition.

Since 1994, over 22,000 units in 1500 buildings have been returned to responsible private ownership, with funds sufficient to provide for extensive renovation and with operating or rental subsidies sufficient to insure that existing tenants would not be displaced, rents would remain affordable and the buildings would be financially viable in the future. Where feasible, we have turned vacant buildings into opportunities for homeownership for working families. We have relied on local entrepreneurs and with extensive experience in property management, and neighborhood-based not-for-profit development organizations with proven track records.

We have been involved in this kind of work since 1978 and have amassed an impressive track record from a once high of 89,000 units of abandoned tax foreclosed units in city ownership to today there are approximately 13,000 units left in city ownership and they are all funded over the next few years for rehabilitation and sale.

Despite our agency's extensive involvement in housing issues in the city, we played no role in the Section 203(k) program and were unaware of the lending activity that was occurring. We became aware of this issue, as others locally did, when tenant evictions and inappropriately high sales prices became to light in some Harlem sales properties and I have to acknowledge Councilman Bill Perkins from this community whose original work helped to bring some of this to our attention.

Twenty-nine organizations participated in the Section 203(k) program in New York City, borrowing funds for 593 properties. Only 2 of those not-for-profit organizations were experienced not-for-profit housing developers and managers that we have worked with over the last two decades involving only 17 of the 593 properties. The remaining 27 organizations played no role in any of our programs over the last three decades and had no track record in housing development that we were aware of. So the core problem with the program, I believe, was a simple one. No local involvement, and that lack of local involvement allowed organizations with no experience to participate in a program which sought to carry out an important but complex task; the renovation and return to responsible ownership of troubled housing, often occupied with vulnerable tenants.

At best, these organizations, had no capacity or skills to carry out the program. At worst, they were involved in a corrupt scam to defraud the Federal Government. The results on the streets of our city are sadly the same. Nearly 600 properties, nearly one-half occupied with tenants, have been left without clear management to handle day-to-day maintenance and operation without rehabilitation and an uncertain future. Of the 593 properties, the vast majority, 346, are located in Brooklyn, primarily in Bushwick and Bedford Stuyvesant. Another 190 are located in Manhattan, primarily Harlem. 40 are in Queens, including some in the Rockaways, which are little more than summer bungalows and the remaining 17 are in the Bronx.

We have inspected every one of these properties with our staff. 285 are vacant, 290 are occupied and 18 are vacant lots. Following inspections of all of these buildings, only 59 were rated to be in good condition. The rest were found to be in fair or poor condition. Since January 1, 1998, our Housing Code inspectors have placed over 18,900 Housing Code violations of these properties alone. We have expended over a million dollars from the city's funds in emergency repairs which our inspectors discovered and the owners failed to correct. Thirteen of these buildings have conditions that are so bad that either the tenants themselves or our attorneys have gone to Court to seek a receiver to insure that the rent roll is spent on providing essential services and repairs. In addition, these buildings are now threatening the significant investment that we have already made on many of the blocks where they are located.

Since early this year, we have been working very closely with HUD officials, both in the New York office as well as in Washington to address these issues. We've crafted protocols so that emergency repairs can be addressed expeditiously. We've exchanged information regarding inspections and foreclosure actions so that we can coordinate our efforts and we've worked to craft a solution that hopefully will result in the renovation of these properties and their return to private responsible ownership. For our part, we have indicated that we are willing to take on the responsibility of structuring financing which leverages private capital and insures affordability for existing tenants, review the design and scope of work for the property's renovation, identify competent developers, both for-profit and not-for-profit, and insure that the work is carried out properly.

In return, we have requested that HUD provide sufficient capital to carry out this work without any administrative fees to our agency, as are customary in HUD programs.

In short, we are suggesting that both agencies do what they do best, and work together to attain the desired results.

October 1st signals the beginning of our official heat season. As of that date, owners of rental property in New York City must maintain adequate heat as the temperature outside begins to drop. It marks our busiest period in enforcement and last winter the Section 203(k) buildings represented a special challenge to us. We are precipitously close to the beginning of a new heat season and hope that these properties will have a more certain future this winter than they did last winter.

Chairwoman KELLY. Ms. Perine, I'm sorry to interrupt you, but you've gone well over your time. Can you summarize for us please?

Ms. PERINE. I want to say we worked very closely with HUD, we had Commissioner Weicher spend an entire day with us touring the properties. I think where we're at in our negotiations are working through the technical issues that have been raised by HUD's counsel. It's not in the substantive part of the proposal, so I have every hope that we're going to be able to conclude negotiations quickly.

[The prepared statement of Jerilyn Perine can be found on page 94 in the appendix.]

Chairwoman KELLY. That's a nice, hopeful note for us to end the testimony on. That's great. I thank you all very much for being here and for being willing to share your knowledge. I have a couple of questions.

Miss Phillips, you stated in your written testimony that the impact of the crisis on housing is potentially the most destructive force in the stability of this community since crack cocaine. I pulled that out of your testimony.

Ms. PHILLIPS. Yes.

Chairwoman KELLY. Is that overstating the problem or has the crisis really harmed families in the community?

Ms. PHILLIPS. What it's done is made these properties and other properties surrounding it, unaffordable to people in the neighborhood. I think the destruction to the buildings where work has been done, we've already seen that, and thanks to some of the efforts that we did early on in the beginning of the year, we had some of these buildings sealed up, but what we found was that the vacant, half constructed buildings were becoming a haven for squatters to come in, potential for fires and destruction to adjacent properties as well as people living in conditions that are very, very bad.

The thing is, I have this great investment, I have one buyer that bought a house. On one side it was a vacant, half finished Section 203(k) building that people were going in and out while the construction was completing, the other side were people who were SRO tenants who were without services. So they were just about to close on a $375,000 house, and they had a commitment to the neighborhood. It also means that if the program had gone forth, even, successfully, these non-profits wanted to make four rental units. That was one person who came to us and tried to buy these at a reduced price, said to us, we're going to do four rental units in here and we're going to put people in from downtown, make lots of money and that will help fund our non-profit.

The other way he said if we can't do this with a downtown rate, we'll put in a special program, which could have been drug treatment facilities, halfway houses and the things that would destabilize areas that were just on the brink of people coming together; new homeowners, people who moved in tax credit buildings who were working to rebuild their communities, so that's the destructive force I'm describing. So we need to have a way to address these conditions immediately. Thank you.

Chairwoman KELLY. Thank you. I have one more question, Miss Phillips. It's directed to your testimony again. I want to know what impact the Section 203(k) scandal has had on organizations like yours in your efforts to rebuild the community beyond just, if you can elaborate a little bit, beyond driving up prices. Has it had an effect on your organization?

Ms. PHILLIPS. First of all, like I said, when I first heard about it, it was a reporter calling me to say we have these churches buying up properties, so they assumed because we had been involved in it, that we knew something about it. I basically brushed it off, because it wasn't in the target area where we were, but the underlying mistrust of non-profits in general. I know we heard testimony here that the guidelines for non-profits particularly participating in this program needs to be strengthened, but I think our HPD and others can say the non-profit working with intermediaries, private developers and the private sector in New York City has been responsible with stabilizing the neighborhood, so that these options would even be possible.

So it really is, and that's one of the reasons why we feel that the existing local non-profits in the area be a part of either helping to renovate these buildings and being able to market them to people in the neighborhood, to help rebuild the credibility of the neighborhood, to help us get the people who now feel that we're now responsible for the gentrification that's pushing them out to say there is another opportunity for you to buy and live and help us rebuild this neighborhood, because they're a very important component of it, so if by this fraud being perpetuated, we're now cut out of helping to bring these projects back, that will limit the amount of future growth that we can have as non-profits in terms of being a part of this economic revitalization.

Chairwoman KELLY. Thank you very much.

I'm going to introduce the gentleman who just came in, Mr. Steve Israel, Congressman from Long Island, New York. Steve, we're glad to have you join us. I turn now to my friend Charlie Rangel.

Mr. RANGEL. Thank you, Madam Chairwoman.

Commissioner, let me congratulate you for the aggressive way you pursued the solution to this problem and ask you whether or not the people at this table are included in the proposal that you have before HUD which we support?

Ms. PERINE. There's no individual organization that's part of this proposal. All we have said to HUD is that we don't need to reinvent the wheel. We already know how to include a vast array of both not-for-profits and for-profit local developers. We would qualify people through requests for qualifications or requests for proposals and people who had already qualified through our existing programs would qualify as they do now. So we made no individual commitment to individual organizations, and presented to HUD instead a framework which is the same framework as we do our other programs, which is the way Abyssinian works with us and HomeWorks and other programs involving city-owned property.

We would certainly expect Abyssinian and other like organizations to participate in those programs. So we see using the same exact framework, we're not trying to make an initial agreement with individual organizations.

Mr. RANGEL. Now, you were saying we hope that negotiations with HUD might soon be completed. Does the term limits facing the present administration in the city adversely affect the program going into place if you do reach agreement before the end of the year?

Ms. PERINE. I don't think so. Again, because that's why I mentioned, we've been doing this work since 1978, and our agency has a long programmatic history doing exactly the same kind of work. It's not, we're not running boutique programs. We're not making up things as an individual fly by-night solution. We have programs that have extended themselves through many different Mayors, many different Commissioners.

Mr. RANGEL. That's what I thought. You do have continuity there.

Ms. PERINE. Absolutely.

Mr. RANGEL. The last question is, are the witnesses at the table satisfied that they would be included in the process, assuming we get it funded, to make certain that the communities involving, in the return of these properties to the communities. Are you satisfied that that will take place?

Mr. MEDINA. I would think that is, as the Commissioner has indicated with respect to an RFP or RFQ process, we are satisfied there would be a broad range of representation for community based organizations.

Mr. RANGEL. Ms. Phillips.

Ms. PHILLIPS. Well, as she mentioned that it would be the same programs that we have now, but if a part of that RFP would give special points for people or groups, organizations who had experience with the local market, be it Brooklyn or Manhattan, and experience track record in that area, particularly those buildings that are now inhabited with SRO, that people who have been working with those tenants be given stronger consideration or extra points for that work, I think would be important.

Mr. RANGEL. In communities that are coming back.

Ms. PHILLIPS. Yes.

Mr. RANGEL. Ms. Tom.

Ms. TOM. We have said all along that we think what is needed to correct the problem is additional resources and it is less important as to whether Enterprise is involved. It does need to include the community-based non-profits and we think HPD has a solid track record, but we think there are resources that need to be committed. I heard $160 million dollars and that's what would be needed.

Mr. RANGEL. That's what you need Congressional support for, and we will be fighting for that money. Thank you.

Chairwoman KELLY. I thank you.

Let's go to Mr. Grucci.

Mr. GRUCCI. Commissioner, just one question. The program has been explained here today as having failed some years ago, I believe my notes indicated it was 1998-1999, where the fraud really started to perpetuate. Did you start to see that here in the city around that time or did it take awhile for it to hit before you started to see the real results of that fraud, and what steps did the city take to identify to HUD these problems and did HUD respond?

Ms. PERINE. Well, unfortunately, we didn't see it until quite recently. As I said, we had no information about these lending practices and really began to see it tangentially in different ways.

One that, we carry out appraisal of all the property that we sell through our programs and our appraisers very recently over this last winter began to see sales prices that just didn't represent comparables in their view. They actually didn't use those appraisals in their own comparables.

The other thing that began to happen over the winter was the issues related to tenant eviction, so those are the two things, that didn't really come to our agency's attention, I would say, until late in November, late in December.

Mr. GRUCCI. If I may interrupt for a moment, my time may run out on me, I want to get another question in. Not knowing how the system works in your department, when you saw the inspectors, or did you see the inspectors that was referenced by HUD being eliminated or removed from the community here, did that raise a red flag in your mind and if it did, what steps were taken to voice that to HUD?

Ms. PERINE. What inspectors are you talking about?

Mr. GRUCCI. If I remember the earlier testimony, there were people that were shifted and moved to make sure the program was running properly and adequately, they were moved to Philadelphia. I may not be correct, but I thought I heard that earlier.

Ms. PERINE. We were not aware of that. We had no contact.

Mr. GRUCCI. You had no interaction with those folks?

Ms. PERINE. We had no interaction whatsoever.

Chairwoman KELLY. Mr. Israel, do you have any questions?

Mr. ISRAEL. I have one brief question. I'm not a Member of this subcommittee and I appreciate the courtesy. I am a Member of the Housing subcommittee and I know that on both subcommittees on both sides of the aisle we recognize our obligation is to protect those innocent victims of the Section 203(k) scam, to punish and pursue those who eluded the program, and to stand up for the best interests of tenants.

I'd like to focus for a moment on one question and ask Ms. Phillips and Ms. Tom to follow up on Mr. Rangel's question regarding community-based input. The agreement that was consummated in January requires that Section 203(k) properties be sold either directly to Harlem based community groups or to their partners for use in the creation of affordable housing opportunities or sold to responsible home buyers who are screened and counseled by Harlem-based groups.

I'd like to know whether you've received assurances from FHA that that provision of the January agreement will be strictly enforced and abided by. Ms. Phillips?

Ms. PHILLIPS. When we met with HUD and Mr. Martinez, there were no parts of the original agreement that were to be still in effect, basically. We offered to him that the affordability of the property, meaning that ther had to be investment from HUD and that we would continue as a group in representing a large group of not-for-profits, that it was not just only the groups that were taking the leadership on this, but a coordinated effort by other non-profits, that we would still stand ready to be a part of the development and sale.

Unofficially, my organization just from people hearing about it in the news media, set up a system to take down the names of people who were interested in purchasing those houses and particularly people from the community, but we have over 600 names, and they're still coming. There are people who are interested in, who live in the community who want to take advantage of or to be homeowners in the community, and so, and a lot of whom fit into this, the categories that we explained, which we were saying 150 percent of median to be the affordability level, to insure that these houses that have pushed the real estate market up would be then targeted to that population of moderate, working class people who now live in the community primarily.

Mr. ISRAEL. Ms. Tom.

Ms. TOM. Enterprise has always been willing and able to step up and be helpful to resolve the issues here and to work with HPD and non-profits. I'm not aware that we have received assurances from HUD that they are committed to working in partnership with the community-based organizations or with Enterprise. I think we're open to hearing it and presenting our proposals, but I don't believe we've heard any assurances from HUD that that definitely is part of their proposal.

Mr. ISRAEL. Thank you, Madam Chairwoman.

Chairwoman KELLY. Thank you very much. I want to say again to this panel that there are some Members who may have additional questions. I will hold the hearing open for 30 days. They would be written questions with written answers, and I want to thank you all for being extremely careful and thoughtful about your testimony. It was interesting reading. You have given us a lot to think about, and I think you've given us, as you said, Ms. Perine, some hope that we're going to be able to get something done and rectify the situation so people can live here in harmony.

So I want to do a couple of other things, then excuse this panel. We had in the room with us listening to all of us, the City Councilman from this area, Mr. Perkins, are you here? I just wanted to acknowledge your presence and thank you so much for your gracious hospitality in letting us come here. We're glad to have you here as a member of the City Council listening. You've been here all morning with us and I appreciate the fact that you're so concerned about the people that you represent so thank you.

Mr. PERKINS. Thank you for your acknowledgment and your presence and I'm optimistic that this testimony will result in some community friendly decisions to develop housing for the people that have been so victimized. Thank you.

Chairwoman KELLY. I thank you.

We also have a man who is a former Congressman who has joined us this morning, Mr. Garcia, Bob Garcia, and we thank you very much for being concerned enough to sit in with us all morning here. Ms. Perine, I want to come back and thank you for working so carefully with HUD, because I think it's that work that will ultimately help us do something that's concrete to help the victims of this scamming that's been going on. With that, I want to thank Mr. Rangel and his staff for their very gracious hospitality and, Mr. Israel, I'm glad you were here to join us and, Mr. Grucci, I'm glad you were here. Your presence added a lot. I thank you for your assistance in making the hearing possible.

Mr. RANGEL. Madam Chairwoman, before we close, if this panel can assure me that before the day is over you will get together so we can regroup at some time to see how we can be helpful with your petition with HUD and how we can make certain that we do have a broad program that would involve the community, because I'd just hate to see you leave without us being assured that we would be working together. Thank you.

Chairwoman KELLY. And also I want to let you know that it's my intention to either speak with or write a letter to Mr. Martinez detailing some of the solutions that have been talked about here today, so again, I thank you very much, and with that, we adjourn.

[Whereupon, at 12:40 p.m., the hearing was adjourned.]

A P P E N D I X

September 10, 2001

News from U.S. Representative

Sue Kelly

For Immediate Release:
Monday, September 10, 2001

Contact: Rob Ostrander
Cell: 914-204-1561

Statement of Rep. Sue Kelly
Chair, Subcommittee on Oversight and Investigations
Hearing on Section 203(k) Program

"The HUD 203K program was intended to strengthen communities and improve available housing. Unfortunately, the fraud perpetrated under this program has had a devastating impact on families and neighborhoods in New York.

"The focus of this hearing will be to find out why this was allowed to happen and how to prevent it from ever happening again. The question that remains unanswered and which I hope we can answer during this hearing is: Where were senior HUD officials while all this fraud was taking place?

"According to reports issued as early as July 1996, the HUD Inspector General and the General Accounting Office found that fraud in the 203k program was harming individual homeowners, renters, and communities and placing taxpayer dollars at risk.

"In July 1996 and again in February 1997, the HUD Inspector General's office said, 'The 203k program is highly vulnerable to waste, fraud, and abuse by investors and non-profit borrowers.'

"Four months later, in June 1997, then-Secretary Cuomo instituted his 2020 Management Reform plan - a plan which raised red flags with federal investigators concerned with HUD's oversight ability.

"Four months after that, in September 1997, the HUD Inspector General issued its Semiannual Report to Congress expressing concern over the fast pace with which then-Secretary Cuomo's reforms were being implemented.

"Secretary Cuomo's plans, federal investigators said, put in jeopardy HUD's ability to effectively oversee its own programs.

"And indeed, starting in late 1997 and into 1998, HUD's single-family program 'was at its most vulnerable point", according to federal investigators. And in 1999, after this scam had become full blown, the GAO said HUD officials still had 'done little to address the problems identified by its Inspector General and others.'

"The warnings were there. Time after time federal investigators warned of abuse. Where was HUD?

"Then-Secretary Cuomo knew this problem existed, yet allowed it to balloon into a $130 million defrauding of the American taxpayer.

"Because of this scam, dozens of co-conspirators - crooked investors, phony non-profits, willing appraisers and greedy attorneys - have already been arrested, with more likely to come.

"These felons falsely inflated the prices of these properties, lied to obtain the HUD-insured loans they needed to buy and rehabilitate the properties, pocketed the money and defaulted on the loans. Every one of us who pays taxes are now stuck with the bill. Again, where were senior HUD officials when taxpayer dollars were being stolen?

"A large part of Sec. Cuomo's plan involved shifting resources, a full 10 percent of staff resources, to his Community Builders Program - a program which served no oversight function whatsoever, but rather a public relations function.

"In fact, the HUD Inspector General, testifying before a Senate panel last year, said "the majority of Community Builders said they spent more than half of their time on public relations activities."

"The Inspector General also said 'HUD redirected a significant amount of resources to outreach and customer relations activities at a time when additional resources were needed for operational activities.'

"Now, many New York families are at risk of losing their homes while other families have been deprived of an opportunity to purchase a home and renters have had to live in buildings that are falling apart.

"Where was HUD while residents of this community were being preyed upon and denied quality housing? Hundreds of millions of dollars in federally insured loans have been lost while criminals lined their pockets with taxpayer money.

"How could this frenzy of corruption have been missed by Secretary Cuomo and senior HUD management in light of repeated warnings by federal investigators?

"Last year, the HUD Inspector General's office testified before the Senate that 'the large number of staff devoted to public relations took away staff resources from important oversight functions.'

"Sadly, this program is a casualty of Secretary Cuomo's obsession with spin and public relations rather than sound public policy.

"In closing, let me cite one last Inspector General's report that addresses this issue. A 1999 HUD Inspector General's report stated that Secretary Cuomo's 'reform' efforts 'had a crippling effect on many of HUD's ongoing operations.'

"Clearly, the 203k program was one of the programs hardest hit by a disturbing pattern of mismanagement and neglect over the past several years."

OPENING STATEMENT OF
LUIS V. GUTIERREZ
RANKING DEMOCRAT
SUBCOMMITTEE ON OVERSIGHT & INVESTIGATIONS
"SECTION 203(K) HOUSING PROGRAM"
September 10, 2001

The 203(k) program is HUD's primary program for the rehabilitation and repair of single family properties and is an essential program for thousands of people throughout our country. The 203(k) program is a crucial tool for community and neighborhood revitalization and for expanding homeownership opportunities.

Section 203(k) program is an excellent means for lenders to demonstrate their commitment to lending in lower income communities and to help meet their responsibilities under the Community Reinvestment Act (CRA).

Unfortunately, the program has attracted some unscrupulous contractors and mortgage companies that have left home buyers living under dangerous conditions. We now need to ensure that people like Brett and Marla Renwick-- who see this program as their only possibility to own a home in cities like New York and Chicago where property values are very high--are protected from being affected by dishonest transactions.

We must also remember that thousands of families are in homes that they could not have purchased without the help of this important program and we must think about the positive role that this program will continue to have in the future of thousands of families. The program's original goal must continue to be reflected in communities around the country.

I look forward to working with government officials, community leaders and members of Congress to help achieve this goal.

STATEMENT BEFORE THE HOUSE
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

JOHN C. WEICHER

ASSISTANT SECRETARY FOR HOUSING/
FEDERAL HOUSING COMMISSIONER

SEPTEMBER 10, 2001
NEW YORK, NEW YORK

I am honored to be here today, on behalf of HUD Secretary Mel Martinez, to describe the efforts by the Secretary and HUD's Office of Housing to address the problems caused by fraud and abuse in FHA's Section 203(k) property rehabilitation program during 1998 and 1999, here in New York City. This is an important hearing to address a major abuse of HUD programs, and we believe that Chairwoman Kelly and Congressman Rangel deserve thanks for conducting this hearing. I also want to thank Commissioner Jerilyn Perine of the New York City Department of Housing Preservation and Development (HPD) for her strong commitment to solving the problems that now confront us all in these properties.

The Department has engaged in an intense effort to understand how the program abuse occurred, how it can best be addressed, and how it can be prevented in the future, here and elsewhere. I will first summarize our current findings and the actions we have taken, and then identify future steps.

With me is Sean Cassidy, General Deputy Assistant Secretary for Housing, who has had direct responsibility for working with our New York office on this problem, on a day-to-day basis. I am also accompanied by the Secretary's Representative in our New York Office, Mary Ann Wilson; by Frederick Douglas, Deputy Assistant Secretary for Single-Family Housing; Joseph McCloskey, Director of the Office of Single Family Asset Management, and Engram Lloyd, Director of the Philadelphia Home Ownership Center. All of these HUD staff members have worked long and hard on this problem.

The 203(k) Program

The Section 203(k) program is the Department's primary program for the rehabilitation of single-family properties. As such, it is an important tool for community and neighborhood rehabilitation and for expanding homeownership opportunities. Under Section 203(k) of the National Housing Act, the FHA is authorized to insure mortgages that finance both the purchase of the home and the repair of the property after purchase. Participating lenders are required to approve "draw-downs" from a repair escrow, and to ensure the adequacy of the repairs themselves. The 203(k) program, as it exists today, was created in 1978. From Fiscal Year 1995 through the end of Fiscal Year 2000, FHA insured over 82,000 mortgages under the provisions of Section 203(k). During the first ten months of Fiscal Year 2001, we have insured another 7,000. It should be noted that, while 203(k) is a single-family home mortgage program, it is possible to obtain FHA insurance for properties with up to four units and larger properties being converted to no more than four units. Properties with one to four family units are defined by statute as "single-family" for the purposes of FHA mortgage insurance. Of the 203(k) mortgages insured from Fiscal Year 1995 through July, 2001, 80% have been on one-family properties, 11% have been on two-family properties, and 9% have been on three- or four-family properties.

The 203(k) program is inherently more risky than FHA's standard home mortgage insurance, because of the repair component. The actual cost of repairs may vary from the original estimate; the repairs may take longer than anticipated; the value of the repaired property may turn out to be less than expected when the loan was underwritten and the mortgage amount insured by FHA is based on the "as-is" value of the property *plus* the estimated costs of allowable repairs (within the overall FHA loan limit cap). FHA has a 14 percent serious default rate on 203(k) loans, compared to 2 percent on the basic 203(b) home mortgage insurance. (Serious defaults are defined as 90-day delinquencies.) The insurance claim rate is about 4.2 percent on 203(k), compared to 0.6 percent on 203(b). The claim rate on 203(k) loans held by non-profits is significantly higher – 10.2 percent.

Program Abuse in New York City

To understand the fraud that occurred in New York, some history is useful. In February 1997 HUD's Office of the Inspector General issued an audit report on the 203(k) program, which was highly critical of the existing management controls. In response to an interim report on this audit, on October 29, 1996 FHA suspended participation by investors in this program. A number of investors circumvented this prohibition, in order to commit fraud, by persuading various nonprofit groups to front for them on the purchase of homes using the 203(k) insured financing. During 1998 and 1999, FHA insured mortgages on 720 properties in and around New York City that were sold to non-profit organizations under HUD's 203(k) insurance program. Most of these properties were located in Brooklyn, Harlem, or the Bronx. The properties were sold to 54 non-profit organizations, which had previously committed to rehabilitate them and resell them in support of community enhancement and affordable housing objectives.

In fact, the actual purchase, renovation, rental and/or resale was conducted by companies with ties to loan officers. Escrowed monies to be used for property rehabilitation were then funneled to so-called developers, who actually did little or no rehabilitation. Kickbacks were paid to the various parties involved in the fraud. Lenders failed to perform their legal duties to ensure that repairs were completed, and that escrow funds were handled in a responsible manner; some were in collusion with the investors.

Within a year, reports from local community groups, HUD "quality assurance reviews" of lenders' operations, and assessments by HUD staff of non-profit participants, revealed a pattern of program abuse that included collusion among non-profits, investors, appraisers, property owners, real estate agents, rehabilitation firms, originating lenders and mortgage servicing companies. An overwhelming number of these loans were apparently originated under false pretenses and are the subject of on-going investigation by the Department of Justice, local authorities, and HUD's own Office of the Inspector General. FHA has been advised that 33 individuals have been indicted to date.

Most importantly, several hundred households are living in appalling conditions. Last week, Mr. Cassidy, Ms. Wilson, Mr. Lloyd, and I looked at 42 of these properties, here in Harlem and also in Brooklyn. We saw vacant lots, burned-out buildings, buildings with missing steps on the front staircase, buildings with broken windows.

Many were boarded up; about half were occupied or partially occupied. Nearly all need significant rehabilitation before they can provide decent housing.

Addressing the Problem

On January 17, 2001, then Secretary Andrew Cuomo signed a Memorandum of Understanding (MOU) between the Department and four nonprofit organizations located in New York City, to address disposition of these properties. Upon his appointment, Secretary Martinez reviewed the MOU; he was concerned that the cost, effectiveness and legality of the MOU had not been determined before it was signed. In reviewing the MOU, HUD legal counsel and program staff identified several concerns. The MOU did not entail a comprehensive commitment to address the problems in all of the properties; it gave the nonprofit signatories the right to refuse transfer of any of these properties, which could result in HUD retaining title to those properties in the worst physical condition. That would certainly complicate neighborhood preservation efforts. The MOU would have violated federal contracting requirements for employing property management firms. In addition, there was no financial analysis of projected repair costs; instead, there was an open-ended commitment of federal resources for rehabilitation. HUD would have abdicated its responsibility to determine the level of rehabilitation that should be undertaken and the cost to the federal government.

Secretary Martinez' foremost concern was for the welfare of the tenants. He directed a HUD team be formed immediately, located in New York City and dedicated to ensuring the appropriate management and disposition of these properties. On May 11, 2001, Secretary Martinez announced the Department's commitment to address the problem. HUD's policy would be:

- To protect all current legal residents and offer them affordable leases;
- To bear the costs of any temporary relocation made necessary by rehabilitation of the property;
- To allow for the disposition of the properties to both for-profit and nonprofit purchasers;
- To bring the property up to minimum property standards (i.e. free of health and safety problems, and supplied with adequate heating, plumbing, electricity, and other basic utilities); and
- To pay the cost of rehabilitating the properties.

To further his commitment to addressing the problem, Secretary Martinez met personally with representatives of the four original signatories to discuss their concerns; from HUD's standpoint, our issues involve the MOU itself, not the signatories. In addition, the Secretary invited HPD to assist in developing a solution that would result in the successful rehabilitation of the properties and their sale to responsible owners.

Insurance claims on these properties are expected to exceed $130 million, which is not inclusive of the costs for property rehabilitation. HUD's initial cost estimate for the rehabilitation was $80 million. In addition, the Department committed to an investment of $25 million for affordable homeownership through purchase money mortgages and affordability discounts.

It is important to note that HUD currently owns only 156 of the properties in question. Another 460 properties are in default, but the sponsors remain the legal owners of record, even though they are now excluded from doing new business with HUD. The Department is urging these owners to manage and maintain the properties, and provide basic utilities to the tenants, but our efforts have been met with considerable resistance. Nevertheless, the HUD project team, led by Secretary's Representative Mary Ann Wilson, is working closely with city officials, mortgage servicers, and community groups, to ensure that basic services such as heating and electricity are available to tenants in all of these properties. When problems are detected, the Department has instructed the mortgage companies currently servicing these loans to directly intervene to re-establish these services, an expense for which they are reimbursed by HUD.

In response to the Secretary's proposal, HPD has recently offered to assume a primary role in overseeing the rehabilitation and disposition of the properties. HPD would draw on its extensive experience in rehabilitating similar properties in New York – in many case properties on the same blocks. HPD's programs have involved some of the signatories to the MOU and other nonprofit and for-profit entities. The Department welcomes this proposal. It is now under active consideration by program staff and the Office of General Counsel. In the interim, the Department is utilizing two property management firms to maintain these properties, establish leases consistent with applicable New York City laws, pay taxes, and ensure that basic utilities remain operational for the properties that are now being conveyed to the Department following foreclosure.

Prosecuting Fraud

As I mentioned earlier, the Department of Justice has active investigations now underway, and HUD staff are supporting both Federal and state investigations. Wherever possible, the Department has proceeded with administrative actions as well. Between October 1, 1999 and August 24, 2001, the Department initiated a wide range of actions against 113 organizations and individuals involved in FHA-insured loans in New York City.

- 83 on-site reviews of lenders have been initiated or completed.
- During this period, HUD's Mortgagee Review Board has taken or is in the process of taking administrative sanctions against 23 lenders within the area. FHA approval has been withdrawn from 5 lenders, and HUD has imposed $1.04

million in civil money penalties. Seven lenders have executed settlement agreements, indemnifying HUD/FHA on losses on 90 loans.

- 3 lender branch offices have been proposed for termination or terminated under the Credit Watch Termination initiative, and another 11 have been placed on warning status as a result of high default and claim rates.

- 8 lenders are under investigation by the Office of the Inspector General.

- 9 lenders were placed in 100% post-endorsement technical review status; HUD staff will review a sample of loans that have been closed and evaluate the lenders' underwriting after the fact.

- 8 lenders were placed in pre-closing review status; the staff in HUD's Home Ownership Center must re-underwrite the loan before it can be closed.
- 7 appraisers have been removed from the FHA Roster; they are no longer permitted to appraise loans for FHA insurance.

- 16 individuals have been referred to the Departmental Enforcement Center for debarment.

- All 54 of the non-profit groups involved are no longer eligible for participation in Single Family programs.

Program Changes to Prevent Future Problems

In addition, the Department is carefully analyzing 203(k) program activity to determine if the situation in New York is indicative of similar problems elsewhere in the country. While problems have been detected with the program, at this time there is no indication that there are other instances or problems that match the scope and depth of impact we have experienced in New York City.

For 203(k) mortgages insured in or after Fiscal Year 1995 to non-profit mortgagors, the cumulative claim rate is 14 percent for loans in New York City, compared to 5 percent for the rest of the country

Since my appointment as FHA Commissioner on June 1, 2001, I have analyzed the programmatic factors that have contributed to this truly tragic situation. There seem to be two primary factors: (1) the involvement of non-profit groups in a volume of work which in many cases exceeded these groups' capacity to perform; (2) the fact that many of the properties were multi-unit buildings and could not be converted to single family residences due to city code restrictions. This combination of factors, combined with the use of the high-risk 203(k) program, created an environment in which fraud could at least temporarily flourish.

The non-profit program has now been changed in several important ways, with the intent to forestall a recurrence of this type of fraud elsewhere. The Department established uniform approval, re-certification, and reporting procedures for non-profit groups. These procedures dramatically reduced the number of nonprofits that are eligible to participate in FHA single-family programs, removing those who did not have the qualifications to do the work. We have also developed and implemented clear guidelines for removal of non-profits participating in FHA activities. In addition, we have limited the number of active 203(k) developments per non-profit to a total of 10. These changes were incorporated in HUD Mortgagee Letter 00-08, issued March 3, 2000. The Department is now contemplating more rigorous controls. I hope to present a series of proposed regulations for public comment and Congressional review within the next few months.

In conclusion, I want to emphasize that Secretary Martinez and the Department, and most particularly FHA, will continue to rigorously review program operations and the program control structure. We are prepared to develop new regulations to modify the specific features of the program that have facilitated these abuses. We will also work with the City of New York, with community groups, with nonprofit and for-profit entities, and with the unfortunate residents of these properties, to make sure that the residents are able to live in decent housing and the buildings do not weaken the neighborhoods in which they are located. The Secretary's first concern is that the families who are living in these properties are decently housed and do not suffer from the fraud that occurred around them. Finally, we will continue to hold lenders, servicers, and other participants accountable for fraudulent activities and for failure to comply with the requirements of our programs.

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Oversight and Investigations, House Financial Services Committee, House of Representatives

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HOMEOWNERSHIP

Problems Persist With HUD's 203(k) Home Rehabilitation Mortgage Insurance Program

Statement of Stanley J. Czerwinski
Director, Physical Infrastructure Issues

GAO
Accountability * Integrity * Reliability

GAO-01-1124T

Madame Chairwoman and Members of the Subcommittee:

We are here today to testify on the Department of Housing and Urban Development's (HUD) 203(k) Home Rehabilitation Mortgage Insurance Program. The 203(k) program was established to help promote the rehabilitation and repair of housing through a program that combines, in one insured mortgage, the funds needed to purchase and rehabilitate a single-family home. The loans are made by banks and other private lenders from their own funds and are insured by HUD's Federal Housing Administration (FHA). The 203(k) program has a history of waste, fraud, and abuse that resulted in our review of HUD's oversight of the program approximately 2 years ago.[1] My testimony today will summarize the findings and recommendations of our report as well as HUD's actions on our recommendations since the report was issued.

In summary, our work showed:

- The 203(k) program is inherently more risky than HUD's principal single-family loan insurance program because its rehabilitation component makes it more complex and susceptible to misuse. HUD's Inspector General and others have noted such risks in 1997 and 1998 reports on the department's management of the program.
- HUD was not adequately targeting 203(k) loans and lenders for review, properly training and overseeing consultants/inspectors, and monitoring nonprofit organization's participation in the program. HUD has implemented three of the four recommendations we made to address these three areas.

Background

The 203(k) Home Rehabilitation Mortgage Insurance Program is HUD's primary program for rehabilitating and repairing single-family homes.[2] Because loans insured under this program have characteristics of both home purchase and construction loans, lenders who want to get a loan insured under the 203(k) program must follow a more complex process to approve and disburse the loans than they would under FHA's other mortgage loan insurance programs. The program provides borrowers the

[1] *Homeownership: Problems Persist with HUD's 203(k) Home Rehabilitation Loan Program* (GAO/RCED-99-124, June 14, 1999)

[2] The Rehabilitation Home Mortgage Insurance program was authorized by section 203(k) of the National Housing Act, as amended, 12 U.S.C. 1709(k).

convenience of financing both the purchase or refinancing of a house and the cost of its rehabilitation through a single mortgage. Eligible borrowers may include the owner/occupant, nonprofit organizations, and investors, although there has been a moratorium on investors' eligibility since October 1996.[3] The program protects lenders against financial losses by insuring a loan for the full value of the rehabilitated home before the rehabilitation process begins. If the borrower defaults and the lender subsequently forecloses on the loan, the lender can file an insurance claim with HUD for the unpaid balance of the loan.

Although the 203(k) program was established in its present form in 1978, it was not widely used until 1994, when HUD began promoting and streamlining the program to make it more user-friendly for borrowers and lenders. As a result of these efforts, the number of 203(k) loans that HUD insured grew from about 4,000 in fiscal year 1994 to over 18,000 in fiscal year 1997. From this peak, the number of insured 203(k) loans fell to about 10,000 in fiscal year 2000. As of July 31, 2001, the total value of HUD's 203(k) portfolio was approximately $4.5 billion.

The 203(k) Program Design Is Inherently Risky

The 203(k) program poses inherent risks because it is much more complex than HUD's largest single-family loan program, the 203(b) program. The 203(k) program's complexity stems from the rehabilitation component of the program, which (1) relies heavily on estimates, reports, and opinions; (2) has many underwriting and funding steps; and (3) involves participants other than the borrower and the lender. For example, to close a 203(k) loan, a lender must set-aside in an escrow account the estimated funds to pay for the rehabilitation. A HUD-approved consultant is often needed to determine the extent of work that must be done to rehabilitate a property and the estimated cost of that work. In addition, a HUD-approved inspector is needed to monitor the progress of the rehabilitation and co-sign with the borrower any request of escrow funds.

The program's high degree of risk is also reflected in the poorer performance of 203(k) loans compared with loans made under the 203(b) program—HUD's largest single-family loan program. For example, for loans made from fiscal years 1994 through 1996, we found that as of September 30, 1998, the cumulative claim rates for 203(k) loans were

[3]Because of abuses by investors in the program, a moratorium on investor participation was implemented in October 1996.

almost double the rates for 203(b) loans. A claim results when a loan goes into default and results in a claim being filed against the insurance fund. In addition, we found that the 203(k) program was expected to incur net losses of over $25 million for loans insured in fiscal years 1994 through 1998, while the 203(b) program was expected to incur net gains for the same period. Consistent with these findings, a 1998 study by HUD contractors asserted that the 203(k) program posed a high risk of loss to the department and that this risk had been reflected in high default and claim rates.

Program Risk Noted in Studies

Both internal and outside reviews of the 203(k) program have concluded that under its current design, the program is susceptible to a variety of problems. For example, HUD's Inspector General reported in 1997 that the program's design encouraged risky property deals, overstated property appraisals, and phony or excessive fees. In addition, an internal HUD study of the 203(k) program identified several inherent program risks, including the failure of participants to accurately estimate the cost of rehabilitation or to complete rehabilitation work in an acceptable manner.

We also found that outside reviews of the 203(k) program concluded that under its current design, the program is susceptible to a variety of problems. For example, in October 1998, contractors hired by HUD to study the 203(k) program reported that the department had done little to reduce the risks of the program. The contractor's draft report identified several major risks associated with the 203(k) program, including program complexity, insufficient lender monitoring, inadequate guidance concerning consultants, hesitant management direction, and increased loss potential from nonprofit organizations.

HUD's Oversight of the 203(k) Program Was Inadequate

During our 1999 review, we found that HUD had not implemented the oversight procedures necessary to mitigate the 203(k) program's unique risks and potential for abuse. Specifically, we found that HUD was not (1) adequately targeting 203(k) loans and lenders for review, (2) properly training and overseeing consultants and home inspectors, and (3) adequately monitoring nonprofit organizations' participation in the program.

HUD's four homeownership centers are responsible for the general management of the 203(k) program in their respective regions. The centers perform technical reviews—desktop audits of loans already insured by FHA—to determine the quality of underwriting for specific loans. They also conduct quality assurance reviews—in-depth reviews of a lender's troubled loans and internal control systems for originating loans—to assess the lenders' performance and operations. Although HUD was aware of the high-risk nature of the 203(k) program, we found that the homeownership centers did not target 203(k) loans for technical reviews. Furthermore, concerning the 203(k) loans they did review, they did not send the detailed results of their evaluations to the lenders. Consequently, the lenders did not have the information necessary to act on the problems that were uncovered by HUD's review. We recommended that HUD improve its identification of lenders' underwriting violations, as well as its notification and penalization of lenders who commit underwriting violations. HUD has not completed action on this recommendation. HUD, however, is in the process of hiring a contractor to review the results of its desk reviews of 203(k) lenders and develop criteria for assessing the risks associated with 203(k) lenders.

We also found that while the homeownership centers had conducted quality assurance reviews of lenders participating in the 203(k) program, they did not specifically target 203(k) loans for review. Officials at two of the centers said they felt that they did not have staff who were qualified to evaluate a lender's underwriting of 203(k) loans. Furthermore, HUD was unable to tell us how many 203(k) loans had been examined as part of its quality assurance reviews. We recommended that HUD target high-risk 203(k) lenders for quality assurance reviews. In response, HUD issued specific procedures in May 2000 for identifying high-risk 203(k) lenders and targeting them for annual monitoring.

Although consultants and inspectors are key participants in the 203(k) program, we found that HUD had no uniform criteria for their training, approval, or evaluation. Consultants and inspectors are used to perform home inspections, identify health and safety problems, and provide descriptions of the work to be performed and cost estimates for homebuyers. In addition to having at least 3 years of specialized experience, consultants and inspectors must receive training in the 203(k) program. However, at two of the four homeownership centers we visited, HUD had not trained any 203(k) consultants and inspectors. In addition, three of the four centers had not evaluated the performance of their consultants or inspectors. Finally, we also found cases in which HUD failed to address consultants' abuses or incompetence. For example, according to customer complaints we reviewed, a 203(k) inspector in Chicago allowed a contractor to receive thousands of dollars for work that the contractor either did not do or did inadequately. We recommended that HUD establish strict criteria to ensure that consultants/inspectors are well versed in residential construction/rehabilitation and cost estimating. In response, HUD issued guidance on July 26, 2000, that sets new standards and procedures for 203(k) consultants participation in the program.

Although approved nonprofit organizations can obtain 203(k) loans, we found that HUD was not adequately ensuring their compliance with HUD's guidelines for participating in the program. HUD's guidelines require the homeownership centers to recertify nonprofit organizations every 2 years. However, at three of the four centers we visited, we found no evidence that the centers had recertified any of their approved nonprofit organizations. Loans to nonprofit organizations represent a small portion of the 203(k) program, but the performance of these loans has been significantly worse than for any other borrower type in the 203(k) program. We recommended that HUD establish strict criteria for qualifying and recertifying nonprofit organizations for their continued participation in the program. In response, HUD issued guidance on March 3, 2000, that sets uniform standards for nonprofit agencies participation and recertification in all FHA activities.

In beginning to implement our recommendations, HUD has taken some positive steps toward tightening its control over the 203(k) program. However, the inherent risk of this program means that the program requires continued management attention and further improvements in oversight.

Madame Chairwoman, this concludes our prepared statement. We are happy to answer any questions that you or Members of the Subcommittee may have.

Contact and Acknowledgments

For future contacts regarding this testimony, please contact Stanley Czerwinski or Paul Schmidt at (202) 512-2834. Individuals making key contributions to this testimony included Paige Smith, Richard Smith, Steve Westley, and Alwynne Wilbur.

STATEMENT OF ROBERT C. GROVES
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OFFICE OF THE INSPECTOR GENERAL
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Monday, September 10, 2001
BEFORE THE SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS
OF THE
COMMITTEE ON FINANCIAL SERVICES
U. S. HOUSE OF REPRESENTATIVES
HUD 203(k) Rehabilitation Loan Fraud

Chairman Kelly, Mr. Gutierrez and other Subcommittee members, I appreciate the opportunity to appear before you today to discuss the frauds associated with HUD's 203(k) rehabilitation mortgage insurance program in New York City. I will first talk about details of our investigations in Harlem and then about what was happening internally in HUD in terms of program oversight. You will see that this fraud, which will ultimately cost the Department tens of millions of dollars, occurred because of a combination of deception, collusion and lax oversight. Mortgage loan funds intended to improve the Harlem neighborhoods were pilfered by various parties to these transactions. HUD and Harlem will suffer from these losses. In the investigation I will describe for you today there have been 33 arrests and 19 of those individuals have entered guilty pleas.

203(k), the New York Investigations

The 203(k) program allows a borrower to get a single mortgage covering the current purchase price of a property in need of repair as well as the estimated cost to rehabilitate that property. HUD must assure that the total costs (cost of property needing repair plus rehabilitation costs) are reasonable for that market area. The program generally requires the rehabilitation portion of the loan to be escrowed by the lender and drawn down as the work is completed over a six-month rehabilitation period. HUD approved direct endorsement lenders generally perform these tasks for FHA during the underwriting process. Obviously such loans carry a greater risk to HUD because of the inherent uncertainties of rehabilitation work.

We began our investigative work a little more than two years ago. HUD's Quality Assurance Division identified a high level of mortgage activity and a high rate of default for the 203(k) program in New York City. At the same time, we received information from HUD's Office of Fair Housing about not-for-profit organizations complaining about mortgage companies. Also, we found that the District Attorney's Office in Manhattan was investigating potential housing abuses by a not-for-profit organization. The scope and breath of these frauds grew bigger and bigger the closer we looked. One lender, Mortgage Lending of America (MLA), was heavily involved in many of the 203(k) frauds in New York City, particularly Harlem. MLA originated about 270 fraudulent 203(k) loans using 13 not-for-profit organizations. The principal value of these loans was $77.8 million dollars and almost all are in default or foreclosure. The frauds involved a combination of actions to include:

- Inflating the initial "as is" value through one or more property flips
- Rigging appraisals that inflated values
- Underestimating the costs for rehabilitation work
- Drawing escrow funds for rehabilitation work not performed
- Falsifying downpayment documentation
- Falsifying loan origination documents
- Equity skimming- collecting rent while not paying the mortgage

The central scheme was to illegally obtain federally insured 203(k) loans by using not-for-profits as fronts to buy properties at inflated values. Values were further inflated by falsely reporting that certain rehabilitation work would be performed. Hundreds of properties were affected by this scandal. It is tangled webs of criminal activity involving real estate investors, not-for-profit organizations, attorneys, appraisers, and lender employees. As the scandals grew, there seemed to be a "feeding frenzy" among the various players that could profit from the vulnerabilities of the 203(k) program. The conspiracy among these parties made the detection of the frauds difficult. Today I will discuss some of the more prevalent schemes.

Property Flipping In the 203(k) program, the process begins with a property needing repairs. A determination is made as to its current "as is" value. That value is generally determined by the purchase price in the marketplace. In the Harlem cases, we found that properties were being bought by real estate investors and then resold to not-for-profits at inflated prices. Not-for-profit organizations, most of which had never been in the housing business, were paid kickbacks from $5000 to $10,000 to make false statements in the loan origination documents and purchase these properties. Investors working with the not-for-profits arranged to cover all the cost of the transaction including the down payment.

The "flip" sale established the "as is" value for the 203(k) transaction. Investors bought up hundreds of Harlem properties in various stages of disrepair and immediately sold them to not-for-profits at a substantial profit. One not-for-profit purchased 104 properties following this scenario. In some of the Harlem cases, the profit on the flip transaction alone was as high as $165,000. In a matter of a few days or sometimes hours, the investors picked up an immediate profit on the purchase and resale of a property. At times, these properties were little more than an existing building foundation. We estimate that in this scheme the co-conspirators made more than $20 million in profit from the flips.

Inflated values for flipped properties. In calculating the 203(k) mortgage amount, the "as is" value plus the estimated rehabilitation costs cannot exceed 110% of the expected market value. The expected values are generally determined by an appraisal company using comparable sales in the same marketplace. In the loan files we examined, unrealistic comparable sales were used and some of the comparables were in different neighborhoods from the property to be insured. While these comparable properties may have been similar in size, they certainly were not comparable in value. Some of the 203(k) properties to be rehabbed were mere foundations. The completed rehabilitation would essentially be a totally new building. It became apparent in the investigation that the information present in the loan files was intended to deceive HUD.

Underestimated Rehabilitation costs The next step was to calculate the rehabilitation cost. We found that the lender generally backed into the rehabilitation number, in other words, the difference between the FHA mortgage limit and the cost for the flipped property. This could not have been done without the full cooperation of the appraisal company. In many of the cases under investigation, there was no real intention to complete the rehabilitation work. With the complicity of the lender, questions were not raised about the reasonableness of the proposed rehabilitation work. In fact, we found several instances where the total cost of the rehabilitation work was lowered by the lender to fit within the insurable mortgage limits. For example, one of the properties was a mere foundation wall. The rehabilitation worksheet called for the entire four unit building to be completed for about $35,000 per unit, not very realistic for New York City.

Underwriting Problems The direct endorsement lender plays a key role in assuring that the loan is underwritten to protect the interest of the FHA insurance fund. Many of the frauds in Harlem involved MLA, which is now out of business. Loan officers were receiving payments for creating the fraudulent loans. Lender employees helped to falsify the credit worthiness of certain not-for-profit buyers and then helped in altering the rehabilitation worksheets so the FHA loan could be made.

Fraudulent Closings We found a number of irregularities in reviewing the property closings. In a number of cases, a real estate attorney assisted the investor in flipping the property to the not-for-profit. We also found where the investor provided the not-for-profit funding to handle the costs of the down payment. The investors and lender employees provided the not-for-profits with selected attorneys for the closings. This assured that the fraudulent transactions would not be detected.

Example Transactions We would like to illustrate the impact of these schemes in the following two examples:

The first is a property at **157 E 121st Street** –The picture depicted on chart provided to the committee (taken from FHA Loan File) was taken in the fall of 1998. An investor purchased this abandoned building on December 18, 1998 for $60,000. Five days later, title to this property was transferred to a not-for-profit for $225,000 on a HUD secured 203(k) mortgage of $355,700. At that time the $225,000 in proceeds was divided among the conspirators. The remaining $130,700 was escrowed to pay rehabilitation costs. This property went into default in less than one year. This next picture was taken two weeks ago. Since it appears that no rehabilitation work was performed on this property, HUD's insurance loss will be substantial.

The second property is at **316 W 113th Street** –The picture depicted in the chart provided to the committee (taken from the FHA loan file) was taken in the summer of 1998. An investor purchased this lot with foundation on July 1, 1998 for just $35,000. Six days later, title to this property was transferred to a not-for-profit for $160,000 on a secured 203(k) mortgage of $327,400. At that time the $160,000 in proceeds was divided among the conspirators. The remaining $167,400 was escrowed to pay rehabilitation costs. This property quickly went into default. This next picture was taken two weeks ago. Since it appears that no rehabilitation work was performed on this property, HUD's insurance loss will be substantial. Since MLA is now out of business, any hopes of recovering the escrow funds on either of these properties are doubtful.

HUD Single Family Operations in FY 98- "staff losses and turnover"

When a scandal of this magnitude occurs, generally the first question is where was the HUD oversight. It is important that the Subcommittee understands that when these frauds were occurring in 1997 and 1998 employees were severely distracted. HUD was undergoing major operational changes in both programs and staffing. The "HUD 2020 Reform" effort was massive, impacting nearly every HUD employee and nearly every aspect of Departmental operations. As former HUD Secretary Cuomo described it in his transformation report, "We could not tinker around the edges, nor could we slowly retrace our steps, taking apart each program one by one to examine and fix the problems. Instead, we would have to start anew. So we began with a blank slate..." Our Semiannual Reports to Congress, starting in September 1997, highlighted our concerns over the disruption caused by this hasty reorganization effort.

Starting in late 1997, and throughout 1998, HUD's single-family program was at its most vulnerable point. Secretary Cuomo announced his "2020 Reform Plan" in June of 1997. Part of that plan involved the downsizing of HUD from its existing level of about 10,500 staff to 7,500 by the start of fiscal year 2002. (In late 1998, the goal of reaching 7500 staff was dropped). With Congressional buyout authority expiring at the end of calendar year 1997, the Department made a major push to use this authority to quickly downsize. About 1,000, mostly senior level, staff took the buyout and left HUD by the end of 1997. Those taking these buyouts were primarily Housing employees. Additionally, many positions within the Department were being abolished with this "new slate" and remaining employees were being forced to apply for positions in the "new" HUD. The focus of many employees time during this period was on survival, i.e. finding a new job outside of HUD or a position in the reorganized Department.

In our Semiannual Report to the Congress for September 1997, we expressed serious concerns over the rapid pace with which the HUD reforms were taking place. Here are a couple of excerpts from our report:

- "Many of HUD's technical staff experts and mid- and senior-level managers have already left the Department, taking with them vast institutional knowledge and program expertise that cannot be easily replaced."

- "In addition to our concern about the sufficiency of a 7,500 staff level, we are also concerned about the relative capacity of HUD's remaining staff to carry out their mission and responsibilities once reforms are in place. Not only is HUD losing significant staff expertise and managerial talent through downsizing, but many remaining staff members may be unfamiliar with their new positions. Thus, HUD may be faced with a lengthy transition period before staff are sufficiently trained and experienced to operate at full capacity."

The 2020 Plan's biggest impact on staffing was in single family housing operations. The Secretary felt that single-family operations could benefit the most from the automation of activities and the contracting out of certain functions.. The Plan called for the consolidation of single family operations into four Homeownership Centers (HOCs). By early 1998, all of New York City's single-family operations had been transferred to the Philadelphia HOC. Before the "2020" reorganization in early 1997, there were close to 360 single-family employees located in those state jurisdictions now served by the Philadelphia HOC. Included in that number were 21 single-family staff in New York City. Today, there are about 210 employees in the Philadelphia HOC.

While staff was declining rapidly, HUD's workload was skyrocketing. In 1998, HUD experienced its largest growth in single-family origination activity and its largest inventory of foreclosed properties in more than 10 years. However, HUD's reduced capacity to handle the increasing workload was not always evident to the outsider. Direct endorsement lenders, that do the vast majority of originations, manage the entire origination process. Limited resources only impacted HUD's ability to oversee. Additionally, HUD lost its expertise about localities, as single-family staff was no longer located in the 80 field offices. Our audit reports during this 1997 and 1998 timeframe noted that HUD's monitoring was dismal. Another major issue, compounding the problems of the HOCs, was the growing problem with Real Estate Owned (REO). In 1997, the REO inventory was at its highest level in 10 years. HUD contracted with Management and Marketing (M&M) Contractors in early 1998 to manage this inventory.

This transition was a huge burden on HUD staff. Further exacerbating the problems was the 1998 bankruptcy of Philadelphia HOC's largest M&M contractor, Intown Properties.

While all this was happening, we continued to point out to senior HUD officials and the Congress, through our Semiannual Reports, that the 2020 Reorganization was creating chaos. We encouraged HUD to slow down and make sure that changes were cost beneficial. The Department used paid consultants to endorse their reform plan and for the most part, our concerns fell on deaf ears.

Growth of the 203(k) Program At the time of these problems FHA loans were originated in Harlem, the Department was making a push to expand homeownership opportunities. The national homeownership strategy of the Clinton Administration was to meet a homeownership goal of 67.5%. The 203(k) program was one of many tools that were available in meeting that goal. While the 203(k) program was created over 30 years ago, it was so complicated that very few lenders or borrowers used it. The Clinton Administration simplified the program so it could be used as an additional homeownership tool. It was seen as a particularly valuable tool for bringing homeownership back to older urban neighborhoods allowing a family to roll the costs of buying and fixing up an existing home into a single first mortgage.

HUD began an aggressive program of marketing and outreach for the 203(k) program in 1994. The program was seen as a cornerstone of HUD's revitalization strategy. Production goals were set for field offices and an aggressive effort was made to promote the program. With an average of about 3,000 203(k) mortgages per year in the early 1990's, activity jumped to 17,000 mortgages in fiscal year 1997. As the volume increased, there was no corresponding increase in oversight by HUD. In fact, with the struggles in setting up the new HOC structure, 203(k) oversight was not a high priority. Since the surge in activity in 1997, 203(k) activity has since fallen off. In 2001, HUD's activity will be about half of what it was in 1997.

OIG's Report on the 203(k) Program in February 1997 We performed a comprehensive audit of the 203(k) program and issued a report which focused on Investor and Non-Profit abuses of the program. The problems noted in this report were exactly the same problems found in Harlem. Here is an excerpt from the executive summary of that report:

> "Our results show that non-profit and investor borrowers have carried out fraudulent or otherwise unnecessary land and refinance transactions to generate money for either the borrower or identity-of-interest parties. They have not made required downpayments. They have obtained loans on properties which did not need significant repairs and should not have been in the program. Investors have been paid for rehabilitation work that was not performed. Non-profit borrowers have obtained large numbers of loans and have been unable to complete the work. Non-profit borrowers have also made large profits, contrary to their stated motivation. Unfortunately, mortgage lenders have contributed to the abuse."

In reaction to our audit work, the Department put a moratorium on investor participation in 203(k) mortgages. However, because of the importance of the program to HUD's revitalization strategy, the Department did not want to stop non-profits from program participation but promised to tighten up on program rules. Unfortunately, while the moratorium was in place and while HUD was working to tighten the rules, many investors saw this as an opportunity to use existing non-profits or create fictitious non-profits to continue abusing the program.

A purchase/rehabilitation mortgage insurance program is inherently complex and requires a substantial training and monitoring commitment from HUD and the lender to assure that transactions are made that pose the least risk to the insurance fund. Small programs, like the 203(k) program, take a huge amount of resources to effectively manage. As I noted earlier, major distractions impacted on HUD's ability to oversee an impending disaster.

GAO's June 1999 report on the 203(k) Program further confirmed that HUD was doing little to address the problems. Their report stated: "Despite the recognized risk associated with the 203(k) program and the potential for mounting losses to the General Insurance Fund, HUD has done little to address the problems identified by its Inspector General and others."

The American people are committed to investing hundreds of millions in poor neighborhoods to make them decent, good places to live. In Harlem, religious and other not-for-profit organizations working in partnership with criminals aggressively pilfered nearly the entire investment that had been set aside to help vulnerable and disadvantaged elements of our society. HUD's very poor management allowed this slow moving theft of huge proportions to go undetected, until it was too late.

In March 2000, HUD took action to limit the number of 203(k) properties for each non-profit to ten incomplete developments. HUD also took action to strengthen the non-profit approval and re-certification processes. HUD and the OIG will carefully track the progress of reforms on the 203(k) program and keep the committee apprised of the effectiveness of those reforms.

HUD's 203K program while attempting to purchase a brownstone in the Mount Morris section of Harlem.

In order to give you some perspective I will mention that my wife is Australian and emigrated here over four years ago to marry me. I was born in Trinidad and emigrated here in 1972 and have lived on at off at the same address in Morningside Heights since then. I consider myself to be a streetwise individual and received my undergraduate degree from NYU but nothing could have prepared us for the cunning deceit of a predatory seller and HUDs evasiveness.

After learning of the 203K program and seeing it as the only viable way for us to own a home in Manhattan we began our search for a brownstone and enlisted the aid of several brokers. Unfortunately all of the brownstones were already sold in spite of the freshly painted "for sale" signs adorning them so we decided to seek out private sellers. We were pre-approved by Fleet, Dime and Chase in addition to taking a one-day, first time homeowner's seminar sponsored by the Greater Harlem Real Estate Board Development Fund at the Met Life office across the street. We proceeded to do everything by the book and kept records of our progress. Marla and I interviewed and retained a reputable lawyer (on Lenox who is well versed in Harlem real estate), and on the recommendation of Dime Savings Bank an architect and contractor. We also retained a HUD certified specialist who would act as our project manager during construction insuring that work was done prior to funds being dispersed to the contractor—all pre-requisites of attaining a 203K loan regardless of the lending institution. Because the $427,000 cap on the 203K loan has not kept pace with prices in Harlem, Marla and I quickly learned that in order to afford to purchase and renovate brownstone it was imperative that the purchase price be less than $200,000 since the average per-floor construction cost would be in the neighborhood of $60,000. We learned quickly that with many vacant brownstones going for $3-600,000 that our dream of home ownership seemed more and more elusive.

After spending days on end at the Surrogates Court trying to determine who the owners of many brownstones were and navigating past pushy real estate agents Marla and I successfully bid on a property 13 months later. Our agent at the Charles Greenthal agency told us of a brownstone at 148 West 121st street that was available and placed a bid immediately. At $180,000 the five-story, burnt out shell of a building with no floors, usable beams, windows or roof and a tree growing in the middle of it seemed like a steal. As you know, the 203K Program is meant to provide affordable homeownership via renter's fees facilitating the repayment of the mortgage. This particular building would have three one-bedroom units and Marla and I would live in the garden floor duplex.

On June 9, 2000, my wife and I met with our lawyer to sign the contract and sipped our first dose of avarice. The seller (one James Johnson, VP of The Shelter House Corporation on 130th Street) had included a four-page rider stating that if any industrial pesticides were found on the property that he had no responsibility for its removal. Furthermore, if we did not close within 30 days our deposit would be kept. Needless to say we crossed all of this silliness out, signed the agreement and returned it to the seller's attorney with a check for $18,000. This $18,000 had an enormous emotional heft to it because of its origin. Several years earlier my wife's father passed away from melanoma and this money is part of an inheritance. This money also lost nearly half of its worth when converted to the US dollar from the Australian dollar. Over the next five business days the seller kept us in suspense by not depositing the check and not signing the agreement. Finally, I called the sellers attorney, Howard Horn and requested quite firmly and with great vehemence that he either instruct his client to sign the agreement immediately or that I would personally show up at his office that afternoon and demand our check. We received a copy of the signed agreement the next business day.

Our lawyer conducted a title search via Liberty Title and once the title was proven to be clean, instructed us to have our architect begin work on the plans for our new home.

Dime informed us that in order to close we were required to bring proof of a termite inspection and liability insurance. We quickly found that it was exceptionally difficult to procure liability insurance for a property that has no roof and opened windows even if they are above the first floor. But our biggest hurdle was a newly discovered Unsafe Building Violation. At the time I believed the violation to be directly related to the gaping hole someone had made in the cinderblock sealed entryway. The opening was roughly a foot and a half wide and provided a view into the carnage a fire caused in 1993. Nothing exists in the house past an entrance with a floor that plummets after five feet and is covered in Colt45 cans. In an effort to remedy the UBV I woke one morning and left my house with a bucket, a bottle of water, and spatula and headed for a hardware store on 125th street where I purchased a 10lb bag of cement. As I walked to the brownstone I stopped at abandoned buildings to procure lose bricks. Upon reaching the building and asking the drunks on the stoop to excuse me I proceeded to mix the cement and seal the hole. Proud of myself and thinking that I had moved us closer to the closing table, I called my contractor and told him what I had done. He stated that with the upper floor windows open and with no roof to speak of that the Building's department would still consider the property to be unsafe. Undaunted, our architect met with the officials in Buildings Department and we continued to revise plans and meet with our contractor. This issue dragged on for weeks and all parties were mystified as to the Buildings Department's unwillingness to understand that regardless of the current unsafe state of the building that we were intent on making it safe. The most interesting thing was the silence we experienced from the seller who at one point informed us that this sale was taking too long and that he would happily return our check—a statement that our lawyer scoffed at.

Then came the bombshell. Our lawyer in the course of a routine conversation with the seller's attorney was told that certain pervious owners of this property were in the process of being indicted and that there was additional debt. My lawyer reviewed the title search she conducted and found no mention of this. She informed us that in the instance of an unrecorded event having taken place that it was referred to as a "cloud on the title." Despite my urging she told us to wait and did not arrange for a closing in spite of the title insurance she had attained. Unfortunately we had already spent over $15,000 in architectural and other fees.

Over the ensuing months the facts came into view. At some point during the previous two years a man named Thomas Starr sold this brownstone to Beulah Church of God in Christ Jesus, Inc. in Brooklyn and allegedly made some sort of financial arrangement with their title company representative to "not" register the sale of this property. This meant that although Beulah (who used the 203K program to purchase this brownstone and 25 others) had paid for the property it would not appear on the City Register as it was supposed to five business days later. Soon after this, Mr. Starr sold the same property to a Harlem resident named James Johnson for $10,000. Mr. Johnson, as the head of a not-for-profit called Shelter House Corporation agreed to sell the property to my wife and I. The title company in question is Stewart Title. My lawyer attained a letter from Stewart Title to the seller's attorney dated September 14, stating that "our agent neglected to record the deeds" and that they would rectify this problem. They did that and revised the title thereby making Beulah the owner of record.

My wife and I had the down payment returned to us but had spent over $15,000 in architectural, legal and other fees and still owe our architect a balance of $3,500 for services rendered. Nearly seven months later my wife and I had tired of trying to reason Stewart Title, the Church, a seller who had disappeared and HUD. HUD especially had taken no responsibility for the program that bares its name and told me it could do nothing. Upon reading a front-page article in the New York Times written by Terry Pristin about the 203K scandal I quickly called her. Within weeks Ms. Pristin had written another article that featured three buyers including my wife and I who had been burned in one manner or another by predatory sellers who defrauded the 203K program.

Soon after this, we met with Darren Walker, the COO of the Abyssinian Development Corporation who had been asked by the departing head of HUD, Andrew Cuomo to help clean up the mess in Harlem. Darren's assured us that HUD (who now referred to my wife and I as the New York Times people) wanted to make good and get us the property. After spending hours upon hours with HUD representatives in both the NY and DC offices repeating the same information over and over nothing happened. HUD dismissed Abyssinian and I was instructed to keep in touch with Peter Spina of HUD in their New York City office. Months passed and my bi-monthly calls ended the same each time. HUD was aware of our predicament and wanted to help but could do nothing although they promised us the house. Finally after hearing this one too many times I wrote the new Secretary of HUD, Mel Martinez a detailed letter asking for a written timeframe for HUD's intervention and a date when my wife and I could purchase the property. His response came in the form of a generic letter from Engram Lloyd, Director of the Home Ownership Center in Philadelphia who had no knowledge of our case. In addition I received a phone call from Ms. Ford who insisted that HUD was a third party with absolutely no ability to influence the outcome of any property being contested. She also stated that HUD would make no promises to us and that she would respond to my letter in kind, which never happened.

As I read this, the Residential Funding Corporation (who purchased the debt from a now defunct mortgage lender) is suing Beulah, Shelter, Starr, the City of New York and various other individuals over a portfolio of properties that includes the one we were under contract to purchase. Despite being told by lawyers that my wife and I should retain counsel and join in this suit in order to be made whole this is not a viable option for us. As a dotcom marketing executive I was laid off in January of this year and although I have sent out hundreds of resumes and gone on many interviews employment continues to elude me so legal action is simply out of the question.

It is our contention that had HUD held tighter reigns over this program that there would be some sort of apparatus in place to identify, label and administrate 203K properties once they have been sold. Our experience in dealing with HUD is that of a disinterested bureaucratic organization that refuses to take responsibility for a program it has written the rules for.

Had HUD done its job, someone from that agency would have seen that Beulah had not begun construction. This never happened. An approved HUD lender like Brucha Mortgage Bankers Corp. (the mortgage lender Beulah secured their funding from) under HUD's own rules, should never have released the full some of money to Beulah prior to work on the property commencing.

Our proposed remedies are as follows: An HUD representative should be compelled to attend every property closing where the seller is procuring an HUD backed loan of any type. This representative should also be required to do follow-up which involves making sure that the sale is recorded correctly and that a "sales freeze" in imposed on the property to avoid any "flipping" of the property by the new owner for a period of at lease one year. Since HPD refuses to sell properties directly to well meaning individuals like my wife and myself choosing instead to sell to anyone off the street willing to purchase several buildings and calling themselves either a developer or not-for-profit the onus should be on that agency to check the credibility of each potential buyer thoroughly and document the construction progress.

At this point in time every city agency works against, not for prospective homebuyers like my wife and myself. The Buildings Department holds up purchases with ridiculous paperwork like changing the Certificate of Occupancy from an SRO to a four-family, having to attain a Certificate of Non-harassment, and ADA compliance in regards to owners building disabled access and bathrooms for able-bodied owner's units.

In spite of everything my wife and I still want to purchase, renovate and live in that brownstone on 121st Street. In closing I would like to thank the members of this Subcommittee for the opportunity to tell a story that has caused my wife and I an enormous amount of emotional grief and expense but wonder what any of you will do on our behalf.

Foncette

KAREN FONCETTE
9 CENTRAL PARK NORTH, APARTMENT 56, NEW YORK, NY 10026
TELEPHONE (212) 876-5495

January 26, 2001

New York State
Attention: Attorney General Office
Consumer Fraud
120 Broadway
New York, NY 10271

Dear Attorney General Spitzer,

This letter concerns my mother Whilma Jacob-Foncette, Unfortunately she is traumatized and his unable to correspond at this moment.

My mother signed a contract on July 24, 2000 to purchase property at 108 W 118th Street, New York, NY 10026. She made a $40,000 check payable to Graynor & Granyor with the agreement of another $40,000 at closing.

The closing was held on November 29, 2000 at 10:00 a.m. After signing all contractual agreements, we were waiting for the final approval and keys. All the required documents along with two checks totaling $68,000 were turned over to the seller's attorney. As we waited, the bank manager stormed in the room and requested a conference with the seller and his attorney. The seller was represented by Carl Fields of Advance Local Development Corporation and attorney Andrew Graynor of the law offices of Graynor & Graynor.

An argument insued and several associates from the bank tore up the contracts and documents. Therefore, all contractual agreements were dissolved. Three large men stood at the door to escort Mr.Graynor & Mr. Fields out of the office and the Suffolk County Police Department was called.

We were informed of an impending investigation being conducted against Mr. Fields and Mr. Graynor for fraud by the Federal Government. Furthermore, Page 2

January 26, 2001

Attention: Attorney General Office

the property is now in foreclosure. There was an article in the New York Times NY times article Metro Section dated November 26 and 29th) circulated concerning the impending fraud charges.

My mother is 72 years old. She is devastated. She does not know whom to trust and is in great distress and fear of being defrauded.

She have sustained expenses for homeowners insurance appraisal, closing cost (for a closing that did not occurred), actuarial cost, architectural drafts, hours of research and a second mortgage (closing cost on my mother's home which was put up for sale for the purchase of said property). In addition, several hours of research in restoration, construction and planning.

I spoke with First Star Mortgage concerning the foreclosure and possible attainment of the property. I am appealing to you for assistance in resolving this issue. In recognition of the current real estate climate in Harlem, I implore you to address the issues at hand. Lastly, What do you suggest, my mother do to secure the property?

Sincerely,

Karen Foncette

Cc: Laurence Hirsh

Attachment enclosed

KAREN FONCETTE
9 CENTRAL PARK NORTH, APARTMENT 56, NEW YORK, NY 10026
TELEPHONE (212) 876-5495

January 26, 2001

Jerry Grundhofer
First Star Mortgage
777 E Wisconsin Avenue
Milwaukee, WI 53202

Dear Mr. Grundhofer:

My mother entered a contractual agreement on July 24, 2000 to purchase a piece of property held by your bank. The property is located at 108 W 118 Street, New York, New York 10026. We had a closing on November 29, 2000. At the closing it was brought to our attention that the property is in foreclosure. The closing did not materialized due to an impending federal investigation for fraud of the seller and his attorney (See the enclosed letter and attachment).

I am appealing to you for consideration of purchasing the property from your bank. Please advise and/or direct us to any avenues we may use in accomplishing our goal of attaining the property.

Sincerely,

Karen Foncette

Cc: Attorney General, Splitzler
Lauence Hirsh

Attachment enclosed

KAREN FONCETTE
9 CENTRAL PARK NORTH, APARTMENT 56, NEW YORK, NY 10026
TELEPHONE (212) 876-5495

February 9, 2001

Abyssinia Development Corporation
131 W. 138th Street
Basement Offices
New York, NY 10030

Dear Mr. Darren Walker,

I spoke with Laurence Hirsch concerning the following correspondence. He suggested I speak with you and enclose the information I sent him.

This letter concerns my mother Whilma Jacob-Foncette, Unfortunately she is traumatized and his unable to correspond at this moment.

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Sincerely,

Karen Foncette

Cc: Attorney General, Splitzler
Lauence Hirsh

Attachment enclosed

Browne

Testimony before the Subcommittee on Oversight and Operations of the House Financial Services Committee:
The Impact on Tenants of Abuses in the HUD 203(k) Program

Submitted by Glorie Browne
September 10, 2001

Good morning, members of the committee, invited guests, tenants of 203(k) buildings and others. Thank you for providing me with this opportunity to address you this morning.

My name is Glorie Browne. I live at 74 West 131st Street here in Harlem. My building is a brownstone rooming house with 13 single room occupancy units, very typical of the vast majority of the Harlem buildings in the 203(k) program. I have lived there for about ten years.

I am here in solidarity with all of my fellow 203(k) neighbors. I am also a tenant in a 203(k) building who has suffered through the injustices of a housing scandal that had nothing to do with housing. It had to do with unscrupulous landlords and money-hungry non-profits that saw opportunities for quick money in buying our buildings, then abandoning them and allowing them to rot. They defrauded a federal loan.program and they also committed fraud against unsuspecting tenants like me. Not only did their crimes leave us without responsible landlords, it also left us with no heat and hot water last winter, leaky ceilings, damaged walls, broken boilers, shaky building infrastructures and no hope. Up to two years after the news of this scandal broke some tenants are still without basic building services.

Almost 200 brownstones in Harlem are caught up in this mess. About 160 of those buildings -- about 85% -- are SRO rooming houses that should never have been in the 203(k) program to begin with. Around 65 of those buildings are currently occupied, by as many as 600 tenants. My story is similar to many 203(k) tenants' stories. My building has never been a palace but my neighbors and I call it home. After the so-called non-profit Beulah Church of God bought the building in 1999, my neighbors and I found ourselves without heat and other basic services. In fact, the first act of the new owners was to shut down the boiler -- in the middle of winter! When we finally went to court to force Beulah to maintain the building, no one from the landlord showed up and the court order we got ordering the landlord to make repairs was never complied with. For over a year there was no garbage pick-up, no repairs made to the very leaky skylight or the broken pipes or the uneven front steps. The gas and electricity were shut off at least once, and the water was shut off a few times, forcing my neighbors and me to wash with bottled water. An inspection last year found 94 violations of the city's housing maintenance code in the public areas alone.

The landlords that committed these crimes were using HUD loan money, money that was supposed to go into rehabilitating buildings. Instead the money disappeared along with the landlords. Now as the scandal continues to unravel we tenants are bearing this huge burden. HUD has finally agreed to take responsibility for maintaining many of the occupied buildings in the program, while others, like mine, have gone to court to get an administrator appointed by the city to run the buildings. What we are most worried about now is the threat that new owners, whether they are private owner-occupiers, not-for-profit groups, or ?entrepreneurs? looking for properties to ?flip,? may try to displace the existing tenants from our buildings or to raise rents beyond what we can afford.

But my intention today is not to tell a story of hopelessness. NO! I am here as a representative of 203(k) tenants with a strong message of hope and self-determination. We are survivors; we are longstanding Harlem tenants ready to reclaim our homes and our community. We are speaking out for the preservation of affordable housing in Harlem. We are standing up for the preservation of our own homes, and we demand to be included in any discussions about their future. We demand full repairs and services in our buildings now. We want legally enforceable assurances from HUD, the city's Department of Housing Preservation and Development and other appropriate parties that no tenants will be displaced when the buildings are finally disposed of. We want guarantees of affordable rents. And we want substantial opportunities to explore the possibility of bringing some of our buildings under tenant ownership and/or control, through mutual housing associations, limited-equity co-ops, or other mechanisms for tenant involvement.

Our demands are not unique. They are the demands of many low-income tenants in this city. I am here as a spokesperson for 203(k) tenants, and we say: We will do everything we must in order to save our homes. We are here to stay!

Thank you and God bless you all.

Medina

Promesa Affordable Single-Room Housing Initiative

Introduction

PROMESA is a Bronx-based Community Development Corporation whose mission is to enable New York City residents, particularly minority and poor, to become self-sufficient citizens who contribute to the quality of life of their neighborhoods. Promesa works to accomplish this by assuming a leadership role in addressing the underserved in the areas of housing, health, education, employment, economic and community development.

Background in Housing Development, Ownership and Management

Promesa recognizes that quality; affordable housing is a vital part of the fabric that holds diverse communities together. In this regard, Promesa's management contributes to stabilizing low-income families and building a stronger community through the development, owning and managing renovated Promesa and city-owned properties. Promesa combines the goals of providing safe, affordable, quality, self-sustaining housing for low and moderate income residents, with social service programs that seek to strengthen residents through tenant organizing and advocacy, youth and family support services, and neighborhood improvement activities.

Since 1990 Promesa has worked closely with the New York City Department of Housing Preservation & Development in creating a substantial amount of affordable and stable rental housing units for low and moderate-income New Yorkers. In 2000, thanks to the assistance of Bronx Community Board #5 and 30 new homeowners, who live near our central offices, Promesa won a $3.9 million new construction development grant from New York State's Homeless Housing Assistance Program. This grant will support the development of affordable rentals for residents with HIV/AIDS. What's interesting about the support of the homeowners? In other efforts, homeowners have been viewed the key opponent in development activities for low-income projects and the sitting of social services facilities. Promesa has created a strong model of neighborhood leadership that gets neighbors to work together. Indeed, Promesa through recognition of its corporate citizenship has helped to stabilize the Mount Hope Community and its unique blend of multi and single-family housing stock. It has given a voice to the neighborhood through the development of neighborhood community councils and homeowners associations. Promesa has acted to help bring services and support to all its neighbors. Promesa's corporate citizenship has helped bridge the gap between renters and owners. As a result many renters are now coming to Promesa to inquire about ownership opportunities and possibilities

Building Community Ownership Through Homeownership

Far too many low and moderate-income neighborhoods in urban settings are without a viable homeownership options. Promesa would like to work closely with local community boards and other not-for-profit community-based housing groups in filling this void. The result would be a continued stabilization of the neighborhood and the development of a constituency of community advocates with interests in the area other than that of not for profit organizations Recently, Promesa applied to HUD to become a 203(k) approved agency to provide such services. Promesa made the application because it felt that it could help foster an environment of home ownership in an urban setting.

Although Promesa does not have direct experience in homeownership in a traditional sense, it has participated in the transfer of city owned buildings that it has renovated and managed to tenant owned cooperatives. Further Promesa is familiar with many of the issues affecting single and small multi unit housing by virtue of its managing its own housing stock, which has included over time a number of brownstones in the area. Because of its banking relationships with several of the City's banking institutions Promesa can help to link families to those lending structures and vehicles most appropriate towards the needs and means of the family. As the corporate neighbor Promesa would help to facilitate the solutions to the problems of homeownership ranging from garbage collection to electrical wiring. These linkages would be an active component of Promesa's homeownership transition for low and moderate-income households. Promesa would transitioned families/individuals in rental situations into homeownership by providing hands-on counseling itself as well as through linkages with established homeownership counseling agencies.

Promesa also has other reasons. Promesa, as a $31 million dollar agency, employs over 400 people. Most of these people live in the area of the main campus. By given them an opportunity to qualify for and buy a home in the area Promesa would have created yet another venue in which to attract and retain quality people for the delivery of its own services.

Promesa would market the homes in accordance with a standard marketing procedure. Outreach to potential buyers will be through advertisements in local and citywide newspapers, radio announcements and presentations to local organizations. Promesa has a strong philosophy about neighborhood stability via community ownership. As mentioned earlier, Promesa actively organizes residents to provide the leadership of their community.

Promesa Affordable SRO Housing Initiative

Through discussions with HUD's regional office in New York, it came to Promesa's attention that a significant number of buildings located primarily in Harlem and Brooklyn under the 203(k) program were actually being used as single resident occupancy ("SROs") structures. Promesa was also told that that under the guidelines established by the 203(k) program, these buildings should have never qualified and could never be actually operated under the 203(k) program. Finally Promesa was informed that the SROs had residents that could never qualify as homeowners and further had a significant number of social and health issues that needed to be addressed. Potential substance abuse and mental health were mentioned as significant concerns for this population

In understanding the dynamics of this population, Promesa is aware of the reluctance and/or inability of people residing in SROs to relocate or seek out opportunities to improve their current living condition. Further, the residents in SROs have been overlooked by a number of housing development organizations, governmental agencies and financial institutions. Promesa has been working with this population since the founding of its agency, and has become successful as an advocate and service provider. Promesa's opinion that it needs to advocate on behalf of this particular population today.

Promesa would like to explore the use of HUD's existing SRO stock under the 203(k) program to address the needs of this existing population and perhaps better utilize the potential capacity. Specifically, Promesa proposes to take the housing stock that fits in the SRO category and create geographically congruent "villages" of these types of units. These villages would then have a number of community-based organizations and development corporations organized into a formal joint venture, which would provide renovations and property management and mental and physical health services along with any other social service or training vehicle. This formal joint venture would provide the basis for stabilization and protection of resident population in the SROs.

In order to guarantee some logistical flexibility and diversification of risk, Promesa proposes converting these villages into formal corporations consisting of 15 –20 buildings such that the joint venture organization can use the inherent value of the properties to provide the basis for recapitalization and renovation. Recognizing that on average these structures are half occupied, critical mass is needed if repairs and renovations are to be made in a timely manner. Although it is our understanding that very few tenants have accepted the offer to relocate permanently, chances are good that they would relocate temporarily if they knew that they would come back to their place of living after renovation.

Although Promesa has not had an opportunity to evaluate the buildings, it is Promesa's expectation that some percentage of the individual units can be renovated and marketed at or close to market rates. The use of grants, tax exempt financing and investment tax credits can offset the cost of renovation of the buildings and units. The combination of the above subsidizations along with mixed rental income approach should create viability for the village. This assumes that HUD is not able to provide the resources needed to perform the renovations that apparently were not done with the original monies coming from 203(k) lenders.

Clearly the current value of many of these properties will not be close to the actual investment made under the 203(k) program. Further future cash flows based on existing population will most likely not support the initial value plus the probable cost of the renovations needed for much of the stock. Further to place constraints on investors regarding the need to protect existing residents will lower prospective value even more so. Chances are good then that bidding out the properties will not result in the recoupment of much, if anything at all, of the initial investment guaranteed by HUD.

While the financial investment made by the banks and guaranteed by HUD may never be recouped perhaps some minor partial compensation can be accomplished over time through future cash flows as a result of service and rental income. Another approach may be to charge a flexible "transaction fee" as part of the right to manage the buildings after transfer. These approaches could be acceptable to both organizations involved in the community development and delivery of service to the population as well as to the investors.

Given the nature and potential size of the SRO housing stock, it is clear that arrangements need to be worked out in individual situations to address the circumstances of that particular village.

In this manner, the residents of the SROs are not packed off in the night because the gentrification of all of a sudden acceptable real estate must go on. Nor are they victims of benign neglect, or are called an obstacle to the stabilization and strengthening of the community.

Further HUD has comfort in that the joint venture is not made up of a single organization that may have good intentions and resources but can veer off the path but rather a formal conglomeration of organizations that participate in the decisions of the operations. Further, by giving residents representation on the governance body, one is assured of a buy in by the residents themselves. HUD has had some positive experiences with this at the Diego Beekman Houses in the Bronx.

Promesa recognizes the importance of building strong working coalitions. Promesa has worked largely with other community-based organizations from all over New York State in its mission to develop affordable housing and provide quality social services. Promesa continues to expand and develop great working relationships outside of the Bronx. One coalition, formed with the Upper Manhattan Mental Services, Inc. and Phase Piggy Back, Inc., addresses quality behavioral health care in Manhattan's Harlem, Inwood and Washington Heights neighborhoods. Further Promesa participates in the Association of Neighborhood and Housing Development and sees ample opportunity to develop a coalition of organizations with resources and expertise to make these villages work. Promesa would utilize and participate under this coalition approach in the acquisition, development and management of SRO housing units as well as provide much needed social, mental health and medical services. Further through it relationships in the Business community it would look to add as part of the partnerships those elements that help to strengthen a neighborhood

Promesa's Ability to Serve the SRO Population

Promesa's array of social and community service include Children's Health Education and Outreach, Community Development, Daycare, HIV/AIDS, Housing, Long Term Care, Primary Health Care, Substance Abuse, Vocational/Educational, Women and Youth Services. The NYS Department of Health's AIDS Institute, NYC Department of

Child Health Initiative, NYS Department of Health & Human Services, NYC Agency for Child Development, NYC Department of Youth & Community Development, NYS Department of Health, NYS Office of Alcohol and Substance Abuse Services, NYC Department of Housing Preservation & Development, US Department of Health and Human Services, provide partial funding of these services. The bulk of Promesa's funding comes from third party revenue and for reimbursment of services provided to its clientele.

Promesa's Vision

Promesa provides a continuum of services, geared toward improving the quality of life of individuals and communities we serve. The continuum, comprised of a spectrum of services that is seamless in delivery, is offered to Promesa's clients to the fullest extent necessary, irrespective of their point of entry into the system. Quality, cost, need, accessibility and ease of delivery are parameters that shape all services provided. These parameters are constantly evaluated, using defined and measurable outcomes, to ensure that the quality of life and the level of satisfaction continue to improve with the individuals and communities serviced by Promesa.

Promesa's Values

Promesa believes that all values should have outcomes that are beneficial to consumers utilizing its services. The clientele must be provided the benefit of appropriate practice and comprehensive treatment planning, in order to assure the achievements of their maximum potential. Thus, all Promesa's services and communication between the clients and the organization must be delivered in a dignified, honest, timely, ethnical and easy to understand manner. The clients must be able to access easily the full level of services, regardless of race, color, creed, religion, national origin, culture, language, gender, sexual orientation, age, disability or impairment.

Phillips

TESTIMONY TO THE CONGRESSIONAL HEARINGS
OF THE

OVERSIGHT AND OPERATIONS SUBCOMMITTEE
OF THE

UNITED STATES HOUSE OF REPRESENTATIVES
FINANCIAL SERVICES COMMITTEE
Monday, September 10, 2001
Adam Clayton Powell, Jr. State Office Building
New York, NY

I am Karen A. Phillips, President and Chief Executive Officer of the Abyssinian Development Corporation, a not for profit corporation initiated by the Abyssinian Baptist Church in 1987, incorporated in 1989 and designated by the U.S. Internal Revenue Service as a 501 (c)3. It is significant today to appear before you in the area ADC serves; a community that has the legacy of being the cultural capital of the world for people of African descent, had been used as a symbol of urban decay, and most recently has been heralded as experiencing a second 'Harlem Renaissance'. Thank you for giving me the opportunity to present testimony before the Oversight and Operations Subcommittee of the House Financial Services Committee and to our own Congressman Charles B. Rangel.

The Subcommittee's purpose of convening this hearing in the Village of Harlem is admirable because the impact of this issue is potentially the most destructive force in the stability of this community since crack cocaine. The problems created by the fraud perpetuated on the United States Department of Housing and Urban Development (HUD) 203 K Program could serve to begin to dismantle the gains that have been made in the rebuilding of this economically distressed community. The commitment nearly 15 years ago by the City of New York fueled the redevelopment by not for profit organizations, the business sector, and private developers.

The real estate market in Harlem has been permanently affected by the miss-use of the HUD 203K program that was designed to facilitate the acquisition and rehabilitation of deteriorated housing containing one to four units. The current panic over the 'gentrification' can be directly traced to the scheme of flipping buildings perpetuated by those who targeted Harlem and Brooklyn in an effort to defraud this useful housing program. It was nearly two years ago that I received calls from City Limits inquiring if I had knowledge of the increase in sales of buildings in the area of 120th Streets. The reporter noted that the purchases were by churches, and assumed that ADC was involved because of our track record in development. None of the names of 'faith-based organizations' were familiar to me. However, based on my experience, the prices quoted as have being paid for vacant brownstones or buildings that housed Single Room Occupants (SROs) exceeded a value that could accommodate the rehabilitation cost to create a feasible project.

About a year later, I was invited to a meeting where a broker was helping one of the groups who owned property financed by the HUD 203K program attempt to sell of properties in bulk. After reviewing the portfolio and the 'discounted' prices being proposed, I quickly realized the problems with the feasibility of the proposal and the issues that would result from these half finished buildings. ADC declined the proposal, but was quickly made aware by neighbors of the issues created by these by properties like garbage, deterioration of adjacent structures and squatters. It was in late December of 2000 however, when Reverend Butts was approached by HUD to help to resolve this crisis. Working with a number of community based organizations, social service groups, local elected officials, Enterprise Foundation and the Community Preservation League, Darren Walker, Chief Operating Officer of ADC crafted and negotiated an agreement with HUD officials at the time. The details of the plan are available and will be outlined by our partners, but the essence is an investment by HUD to insure that the vacant buildings are developed as affordable homeownership opportunities and that the current residents not be displaced.

The success of faith based organizations in assisting in the redevelopment of housing in areas of Harlem and Brooklyn, made these areas attraction to those unscrupulous real estate professionals. They sought out faith based organizations to take advantage of the HUD 203K Program adjustments for not for profits and the numerous deteriorated, privately owned properties in these communities. These sometimes-unsuspecting churches were enticed by getting into the housing business, and their plan was to create rental units to generate income for the faith-based groups. The Director of one of these group said to me, "We could make tons of money renting four apartments to downtown folks or putting in some special needs programs." Because not one of these faith based organizations was from the area, they were oblivious to the fact that these buildings could lead to the decline of the neighborhoods where they are located. Projects funded using the HUD 203K program that created only rental units would create absentee landlord situations with a population that often has no long term connection to the neighborhood. This is the condition which organizations like ADC have sought to mitigate by using a comprehensive approach community building.

ADC has a mission that includes the creation of housing for a variety of income levels - from transitional housing for the homeless to homeownership of renovated brownstones, several which are adjacent to these properties The bulk of the nearly 1,000 units that ADC has created utilized the Federal low income housing tax credits. To provide goods and services to the residents of the community, ADC has helped to spur the economic revitalization of Harlem by developing the Pathmark Supermarket. and the Harlem Center shopping centers currently under construction just down the street. Most important to the community's rebirth and its future are the family and community services we provide to stabilize families, prepare them for growth and connections to the mainstream economic system. We have staff that organizes residents to become involved in the transformation of the community. ADC provides education facilities like the Annie G. Newsome Headstart Center and Thurgood Marshall Academy, a partnership between the NYC Board of Education, the New Visions for Public Education Program and ADC. This is a public school, for local middle and high school students that in two years will relocate into the first new school building in 30 years.

Having nearly 200 properties scattered around this community that are boarded up or in deteriorated conditions with poor tenants that have no services has a devastating effect on a community that is trying to rebuild itself. Many are located on blocks where ADC has property and works with Block associations struggling to keep their area clean, address the problems of drugs and related crimes, and maintain open spaces and the streetscape. These properties do not contribute positively to their efforts, but have been a negative factor by attracting garbage and become havens for illicit activities.

The most serious long-term impact will be the artificial jump in real estate values caused by flipping of properties by those who carried out the fraud on the HUD 203K Program. There had been a normal increase in the property values and real estate prices as a result in the redevelopment in the Harlem area over the past 15 years. A recent study by New York University Law School Professor Schill and others documented the impact of subsidized development for homeownership on property values in area surrounding the projects of the New York City Housing Partnership. My first hand knowledge of this area's real estate market is found in the Citihomes program, developed by NYC Department of Housing Preservation and Development (HPD, The Enterprise Foundation and the Community Preservation Corporation with marketing by ADC. The average brownstone prices for two to three unit, completely renovated buildings were approximately $115,000 in Phase I [1994], and $230,000 in Phase II [1996] for families with incomes below 150% of median income. Though this project received a considerable subsidy of public and private funds, these prices were close to the market values at the time of the Central and East Harlem areas where they were located. In 1999 we began the development of brownstones as part of NYC HPD's Homeworks program, using formerly city owned property to create two to four unit renovated houses for sale with no income restrictions. The prices of those completed brownstones, that are now sold, ranged from approximately $330,000 to $500,000, and we are now beginning the construction of the second half of these 33 buildings. The development of these properties was done on City-owned property that had a minimal cost and with a small amount of subsidy. Therefore, the houses that were illegally flipped by the crooks immediately pushed up real estate prices beyond what the regular market could bear. However, when real estate brokers many who were not familiar with the Harlem market, saw these recorded sales and the prices of the HPD sponsored programs, they saw activity that drew them to enter into the area. Other private brownstone prices increased and suddenly shells of buildings, those needed complete renovation, were being marketed for around $200,000. This was close to prices showing up in the properties used for the HUD 203K program scam and with approximately $100,000 per floor for rehab cost, would put the average property over the actual market value, in my opinion.

A *New York Times* article from November 26, 2000 noted that the downtown brokers were beginning to realize that there was not the product that they anticipated in Harlem to justify the opening of new real estate offices uptown. Upon further investigation of the numerous transactions that they had observed, these brokers found that the properties were not available. Though not expressed at that time, it is obvious that their initial optimism about Harlem was fueled by the HUD 203K scandal properties. The attraction had been that you could find houses for a fraction of the cost that they could be obtained just 50 blocks south. Though the complexities of the Harlem market made it less attractive for the high-end market for real estate in Manhattan, the surge in activity and prices has brought about a frenzy of interest in our wonderful housing stock and sparked the fear of gentrification. The perception of gentrification [i.e. people from the outside will move out all of the poor people of color] is more debilitating than the actual reality. Wholesale gentrification cannot be put in place in a community where there has been redevelopment of previously vacant, city-owned property has its affordability tied to long term financing.

The issue now is how do we salvage the "core principles" of the plan signed on January 17, 2001, reflecting the need to strengthen the community, promote homeownership, and increase the availability of affordable housing. The current administration at HUD has rejected the plan by the New York City Group composed of ADC, East Brooklyn Congregations, CPC and Enterprise Foundation. Therefore ADC recommends that HUD continue to negotiate with NYC HPD to orchestrate the process of the disposition of these properties throughout the city.

Their experience in addressing the development process of building in the exact same conditions and in the same communities can facilitate the process and we would be willing to participate in these future programs. Existing HPD programs can manage the orderly relocation of existing SRO residents while repairs are made in their homes with the deteriorated living conditions. <u>HUD must be willing to put up the funds necessary to make a large portion of these properties affordable for moderate-income individuals</u>. The figures we originally calculated were rejected, but HPD has put forth recommendations based on their expensive experience that must be carefully considered. It is also important that preference be given for purchasing to residents of the areas where the properties are located, as is normally found in HPD programs. We strongly feel that selling the portfolio to the highest bidder will again lead to problems of absentee landlords instead of owner occupants that the HUD 203K Program was designed to facilitate. Most important in the resolution of this issue is the need for an immediate investment by HUD in the stabilization of the occupied properties.

Thank you.

Testimony to The Committee on Financial Services
Subcommittee on Oversight and Investigations
Adam Clayton Powell State Office Building
Monday, September 10, 2001

I. Introduction to The Enterprise Foundation

The Enterprise Foundation is a national intermediary, which has been working to improve living conditions in low-income communities from the time it was founded by visionary real estate developer Jim Rouse in 1982. Working with a national network of over 1,900 nonprofit organizations – as well as private sector and government partners at all levels – The Enterprise Foundation operates from the conviction that developing quality affordable housing is the essential first step in a holistic approach to fighting poverty. Moreover, we believe that creating stable communities provides every individual and family in the United States with the opportunity to enter into the mainstream of American life. Consequently, The Enterprise Foundation strengthens its investments in America's transformational neighborhoods by providing community safety programs, as well as access to jobs and child care.

II. The Enterprise Foundation's Investment in New York City

Since opening a New York office in 1986, The Enterprise Foundation has helped develop over 11,000 affordable apartments in more than 850 formerly abandoned buildings throughout the greater metropolitan area. This has resulted in improved living conditions for more than 33,000 people – including over 13,000 children.

The Enterprise Foundation's work in New York City is done in collaboration with over 80 legitimate nonprofits – community-based organizations whose leaders have identified their own neighborhoods' most pressing needs and developed workable strategies for solving their own problems. By leveraging investments – from financial institutions, individual donors, foundations, corporations and government agencies – with the skills, dedication, and grassroots networking capabilities of these community leaders, we are able to develop housing programs uniquely qualified to help break the terrible cycle of poverty in the respective communities we serve.

In addition to our work developing affordable rental housing with our community partners, we also have created opportunities for homeownership for low- and moderate-income families through our visionary CityHome Program. Working in collaboration with the New York City department of Housing Preservation and Development (HPD), The Community Preservation Corporation (CPC), and a number of community-based non-profits, we returned nearly 500 dilapidated tax-delinquent properties to the housing market in low-income communities in Harlem, Brooklyn, and the Bronx. Our current involvement in low-income home ownership opportunities includes a significant commitment of over $2.2 millon in short-term low-interest loans to community-based organizations in collaboration with HPD's Neighborhood Homes program.

III. The Positive Effects of Home Ownership on Low-Income Communities

It is the experience of The Enterprise Foundation – in New York City and across the United States – that home ownership creates a stabilizing effect on low-income communities in transition. Families who live in their own homes are far more likely to consider themselves stakeholders in their communities with regard to an entire spectrum of issues – ranging from maintenance to reducing crime.

But this is not merely our opinion. A recently released study funded by the Fannie Mae Foundation (described in detail in the attached article from *The New York Times*, July 30, 2001), documents a wide variety of ways in which government-subsidized homeownership programs help stabilize neighborhoods. The study also documents – in minute detail – the overwhelmingly positive effects such programs have on neighboring property values. Unfortunately, the study's only discouraging finding was how little housing stock remains to be rehabilitated in New York City in contrast to the staggering need. Thus, the troubled 203(k)-financed properties at issue today provide an increasingly rare opportunity for the City and its longtime community-based partners to continue their demonstrably successful large-scale affordable homeownership initiatives.

IV. The Enterprise Foundation and the 203(k) Crisis

Because The Enterprise Foundation only became involved with the New York City 203(k) program after the fraudulent activity had been detected, we cannot comment on that part of the program's history.

The Enterprise Foundation was approached by HUD in December of last year to help develop a workable solution to the emerging 203(k) problem. From our first discussions with HUD, Enterprise raised the importance of working with members of the affected communities in moving forward. We also strongly recommended that HUD develop a programmatic approach to rehabilitating the properties in question and returning them to the housing market.

A significant number of the affected properties are occupied by existing tenants. Some are Single Room Occupancies (SROs), legal and illegal. Efforts to properly manage these homes and ensure affordability and non-displacement without appropriate relocation need to be made for these residents, who are victims of the 203(k) problem.

Because of our experience with CityHome and other renovation programs, including occupied rehabilitation, we believe – and clearly stated to HUD – that there exist a number of viable models for working with legitimate nonprofits to renovate these properties and market them as home ownership and/or rental opportunities for low- and moderate-income people. From the beginning of our involvement, we urged HUD to see the damage left by the 203(k) problem as an opportunity to invest in the communities where the properties are located by creating home ownership opportunities. Such opportunities could only reinforce the investments that HUD has already made in these same communities.

Regardless of how HUD was to proceed, two points seemed irrefutable: that further investment would be needed to bring the homes in question up to habitability; and that the longer the damaged portfolio remained dormant, the more damage would done to the investments made to date. It was our recommendation that HUD subsidize all further renovations needed to make the properties habitable – no matter how significant – in order to keep the buildings' eventual sales prices affordable to local residents.

The Enterprise Foundation, CPC, and Abyssinian Development Corporation urged HUD to make sure it put processes in motion to evaluate potential contractors, lenders, and prospective buyers, and the original Memorandum of Understanding written by Secretary Cuomo detailed specific roles and responsibilities for each organization participating in the solution to this very serious problem. We have shared these same views with the new team at HUD, with whom we have worked constructively, including at a meeting with Secretary Martinez and senior HUD officials in July.

V. Moving Forward

It is The Enterprise Foundation's firm conviction that the only viable solution to the 203(k) problem will involve a holistic and programmatic approach that will impact the long-range fiscal health of the communities involved by continuing to develop opportunities for low-and middle-income home ownership. We further believe that it is HUD's responsibility to designate every property in the portfolio as a low- or middle-income home ownership opportunity. The Section 203(k) program had been designed as a flexible mortgage product to acquire and rehabilitate foreclosed properties for affordable housing. To that end, we find the $80 million currently budgeted by HUD for the rehabilitation and marketing of these properties woefully inadequate to the task.

New York City's department of Housing Preservation and Development – the most sophisticated municipal housing agency in the country, with the most experience in rehabilitating and disposing of distressed properties – estimates that it will take $160 million to redevelop the portfolio. We strongly urge HUD to invest in the continued stabilization of these communities by appropriating sufficient funds to maintain the integrity of its previous investment. Because of HPD's vast experience and their current investment in these neighborhoods, we also recommend that HUD work closely with HPD as the entity to carry out a program to rehabilitate these properties. Most importantly, we urge HUD to recognize the tremendous expertise of legitimate community based non-profits such as Abyssinian Development Corporation and East Brooklyn churches as critical partners in carrying out such a program.

Harlem and Brooklyn's low-income neighborhoods have come a long way in recent years. Their progress has transformed the lives of thousands of working New Yorkers and benefited the entire City. But their success is fragile. For progress to continue, the residents, community groups and private and public sector partners that have made it possible must have confidence that their efforts—and their hopes for further revitalization—will not be eroded by bad practices reminiscent of the unhappy past. Property flipping and rampant real estate speculation could douse the flames of Harlem and Brooklyn's continuing redevelopment. Fixing the 203(k) problem in the manner we have described would help assure that does not happen and make a positive result from a negative situation.

Thanks you for the opportunity to testify.

Federal Funds Awarded - 1998 through 2000

Awarding Agency/Client	Source of Federal Funds	Contract/Grant Number	Award Date	End Date	Award Value
Department of Housing & Urban Development	Same	B-97-NC-MD-0002	1/30/1998	1/30/2002	$4,550,000
Texas Planning Council for Develop. Disabilities	Same	DD98211	6/1/1998	5/31/1999	$241,578
State of Utah	Dept.of Housing & Urban Devel.	98-249/244-OR	7/1/1998	6/30/2001	$186,667
Corporation for National Service	Same	95ADNMD007	9/2/1998	12/31/1999	$1,366,646
Department of Housing & Urban Development	Same	B-98-NC-MD-0004	9/30/1998	9/29/2002	$7,500,000
Oregon Commission	Corporation for National Service	94ADCORO381101	10/1/1998	9/30/2000	$443,010
Corporation for National Service	Same	98APNMD053	11/1/1998	4/26/2001	$143,675
Department of Labor	Same	Y-7187-9-00-81-60	2/1/1999	3/31/2002	$7,999,687
Department of Housing & Urban Development	Same	MD-BG-000299	2/1/1999	1/31/2002	$387,209
Department of Housing & Urban Development	Same	MD-HO-000599	2/1/1999	1/31/2002	$3,577,741
Department of Housing & Urban Development	Same	MD-HM-000399	2/1/1999	1/31/2002	$1,673,282
Department of Housing & Urban Development	Same	MD-SH-000799	2/1/1999	1/31/2002	$465,878
Ohio Capitol Corporation	Dept.of Housing & Urban Devel.	99-472-CLEV(Cartales)	5/1/1999	4/30/2002	$345,000
NYCHA	Dept.of Housing & Urban Devel.	99-299-HOPEVI-NYC	5/14/1999	5/13/2001	$600,000
City & County of Denver	Dept. of Labor	GE91138	5/17/1999	5/16/2000	$200,000
Texas Planning Council for Develop. Disabilities	Same	DD99311	6/1/1999	7/30/2000	$250,000
Texas Planning Council for Develop. Disabilities	Same	DD99117	7/1/1999	5/31/2004	$1,050,000
Department of Housing & Urban Development	Same	B-99-SP-MD-0138	8/23/1999	8/22/2001	$500,000
City & County of Denver	Dept.of Housing & Urban Devel.	00-054-DENV	9/1/1999	12/31/2000	$45,000
City & County of Denver	Dept.of Housing & Urban Devel.	GE02018	9/1/1999	12/31/2000	$241,850
NYC HPD	Dept. of Labor	99-385-NYC-HPD	10/1/1999	9/30/2001	$5,500,000
Corporation for National Service	Same	95ADNMD007	10/22/1999	12/31/2000	$1,327,733
Department of Housing & Urban Development	Same	B-99-NC-MD-0005	11/8/1999	11/7/2003	$7,500,000
Department of Housing & Urban Development	Same	B-00-NC-MD-0006	1/1/2000	12/31/2004	$10,000,000
City & County of Denver	Dept.of Housing & Urban Devel.	GE01163	1/1/2000	12/31/2000	$175,000
				Total	**$56,269,956**

203 K Testimony by Jerilyn Perine

Submitted to:

Subcommittee on Oversight and Investigations
U.S. House of Representatives
Committee on Financial Services
September 10, 2001 10:00AM
2nd Floor Art Gallery
Adam Clayton Powell State Office Building
163 West 125th Street, New York, New York

My name is Jerilyn Perine and I am the Commissioner of New York City's Department of Housing Preservation and Development. I would like to thank Chairwoman Kelly, and the other members of the subcommittee for inviting me to offer testimony this morning.

You have asked that I address my agency's participation in the 203(k) program, its problems and what recommendation we would offer to resolve the problems we are facing today.

Let me begin by providing the committee with a brief overview of our agency's functions so that you can better understand the role that we play locally. Our agency is a unique municipal housing agency because we encompass planning, development and enforcement functions related to housing and community development. This includes providing city owned property along with construction and permanent financing for affordable housing development as well as for retail and commercial development in underserved communities. Over 68,000 units have been renovated or newly constructed through our programs since 1994. In addition we place a great emphasis on housing preservation through below market loans to owners in need of rehabilitation financing, direct counseling and education for owners to help them to become better managers and we operate the most extensive housing enforcement system in the country, handling over 300,000 calls a year, mostly from tenants and conducting over 200,000 inspections which resulted in 322,000 housing code violations last fiscal year. If not corrected, our own Emergency Repair Program carries out emergency repairs that result in a lien against the property. With a special team of attorneys, we litigate against owners to obtain civil or criminal penalties and court ordered repairs and will seek receivers to ensure that the rent roll is used to provide essential services and repairs.

In addition since 1994 we have been aggressively returning to private ownership, the stock of dilapidated housing that came into city ownership because of tax delinquency. Located primarily in Harlem, the South Bronx and Central Brooklyn, these buildings provided housing for some of our poorest families, but were typically in the worst condition. Since 1994 over 22,000 units in 1500 buildings have been returned to responsible private ownership, with funds sufficient to provide for extensive renovation and with operating or rental subsidies sufficient to ensure that existing tenants would not be displaced, rents would remain affordable and the buildings would be financially viable into the future. Where feasible we have turned vacant buildings into opportunities for homeownership for working families.

We have relied on local entrepreneurs with extensive experience in property management in these communities, neighborhood based not-for-profit housing development organizations with proven track records, and the tenants themselves when they agree to participate in a rigorous training program to learn to self manage their buildings in order to become cooperative owners.

HPD has been actively involved in this type of work since 1978 and has amassed an impressive track record. From a once high of 89,000 units of abandoned tax foreclosed property in city ownership, today there are approximately 13,000 units left in city ownership and they are all funded over the next few years for rehabilitation and sale. In addition our programs have helped to fuel the development of growth of over 100 locally based community organizations involved in this work and an extensive network of local property managers and developers. While 60% of our housing stock was built before 1947, the dilapidation rate is only 1%, the lowest it has been since the U.S. Census Bureau has been measuring it in the mid 1960's.

Despite our agency's extensive involvement in housing issues in the City, we played no role in the 203(k) program, and were unaware of the lending activity that was occurring. We became aware of the issue, as others locally did, when tenant evictions and inappropriately high sales prices began to come to light in some Harlem properties.

29 organizations participated in the 203(k) program in New York City, borrowing funds for 593 properties. Only 2 of them were experienced not for profit housing developers and managers that we have worked with over the last two decades, involving only 17 of the 593 properties. The remaining 27 organizations played no role in any of our programs and had no track record in housing development that we were aware of.

So the core problem with the program I believe was a simple one – no local involvement. And that lack of local involvement allowed organizations with no experience, to participate in a program which sought to carry out an important – but complex task – the renovation and return to responsible ownership of troubled housing, often occupied with vulnerable tenants. At best these organizations had no capacity or skills to carry out the program, at worst they were involved in a corrupt scam to defraud the federal government. The results on the streets of our city sadly are the same. Nearly 600 properties, nearly one half occupied with tenants, have been left without clear management to handle day-to-day maintenance and operation, without rehabilitation and an uncertain future.

Of the 593 properties, the vast majority, 346, is located in Brooklyn, primarily in Bushwick and Bedford Stuyvesant. Another 190 are located in Manhattan, primarily Harlem. 40 are located in Queens, including those in the Rockaways, which are little more than bungaloes, and the remaining 17 are in the Bronx. 285 of these properties are vacant, 290 are occupied and 18 are vacant lots. Following inspections of all of the buildings, only 59 were rated to be in good condition. The rest were found to be in fair or poor condition.

Since January 1,1998 our housing code inspectors have placed over 18,900 housing code violations on these properties. We have expended over $1million for emergency repairs which our inspectors discovered and the owners failed to correct. 13 of these buildings have conditions that are so bad that either the tenants themselves or our attorneys have gone to court to seek a receiver to ensure that the rent role is spent on providing essential services and repairs.

In addition these buildings are now threatening the significant investment that we have already made on many of the blocks where they are located.

Since early this year, we have worked very closely with HUD officials, both in the New York office as well as in Washington to address the short term and long term issues. We have crafted protocols so that emergency repairs can be addressed expeditiously. We have exchanged information regarding inspections and foreclosure actions so that we can coordinate our efforts effectively. And we have worked to craft a solution that hopefully will result in the renovation of these properties and their return to responsible private ownership.

For our part we have indicated that we are willing to take on the responsibility of structuring financing which leverages private capital and ensures affordability for existing tenants, review the design and scope of work for the property's renovation, identify competent developers, both for profit and not for profit, and ensure that the work is carried our properly. In return we have requested that HUD provide sufficient capital to carry out this work, without any administrative fees to our agency as are customary in HUD programs.

In short we are suggesting that both agencies do what they do best and work together to obtain the desired results.

October 1st signals the beginning of our official "heat season". As of that date owners of rental property in NYC must maintain adequate heat as the temperature outside begins to drop. It marks our busiest period in enforcement and last winter the 203 (k) buildings represented a special challenge. We are precipitously close to the beginning of a new heat season and hope that these properties will have a more certain future this winter than they did last winter.

We have seen an unprecedented willingness from HUD to work through the problems resulting from this program and we have been grateful that high-level HUD officials have spent extensive time and effort on this problem. As a result we have been able to address many other long-standing local issues that we had struggled with. We have had an ongoing meaningful dialogue and while there are still some details to resolve we believe that there is a genuine commitment to continue this process through to its successful conclusion.

Thank you for allowing me to address you this morning and I would be happy to answer any questions that you may have.

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